Nos. 15-233 & 15-255

In The Supreme Court of the United States

THE COMMONWEALTH OF PUERTO RICO, ALEJANDRO GARCÍA PADILLA, as Governor of the Commonwealth of Puerto Rico, and CÉSAR MIRANDA RODRÍGUEZ, as Secretary of Justice of the Commonwealth of Puerto Rico,

Petitioners,

v.

FRANKLIN CALIFORNIA TAX-FREE TRUST, et al.,

Respondents.

On Writs Of Certiorari To The United States Court Of Appeals For The First Circuit

BRIEF FOR FRANKLIN RESPONDENTS

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QUESTION PRESENTED

Since 1946, the Bankruptcy Code has expressly prohibited "State" laws authorizing municipal debt compositions that bind non-consenting creditors. 11 U.S.C. § 903(1). In 1984, Congress amended the Code to add a definition of "State" that includes Puerto Rico and the District of Columbia for all purposes except eligibility for Chapter 9 of the Code. In 2014, Puerto Rico enacted its own municipal composition law, which mirrors Chapter 9 but is more onerous to creditors in key respects. Is Puerto Rico's statute preempted by Section 903(1)?

RULE 29.6 STATEMENT

In accordance with Rule 29.6 of the Rules of the Supreme Court of the United States, the Franklin Plaintiffs confirm that the corporate disclosure statement filed in connection with their brief in opposition to certiorari remains correct.

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CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Pertinent statutes are reprinted in the Appendix, along with the official translation of a decision of the Supreme Court of Puerto Rico.

STATEMENT OF THE CASE

The Franklin Respondents, consisting of two sets of mutual funds for which OppenheimerFunds, Inc. and Franklin Advisers, Inc. serve as investment advisors, are holders of approximately $1.61 billion in bonds issued by the Puerto Rico Electric Power Authority ("PREPA"). The Franklin Respondents incorporate by reference the Statement of the Case set forth in the brief of respondent BlueMountain Capital Management, LLC ("BlueMountain").

INTRODUCTION AND SUMMARY OF ARGUMENT

This case concerns a provision of the federal Bankruptcy Code – Section 903(1) – that expressly preempts "State" laws authorizing non-consensual compositions of municipal debt.

Congress first enacted this provision in 1946, for the specific purpose of overruling *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), which for the first time had sustained a state municipal

restructuring law in the face of a Contract Clause challenge.

Congress re-enacted the provision in 1976, and again in 1978 as part of the current Chapter 9 of the Bankruptcy Code, each time for the express purpose of ensuring that "[o]nly under a Federal law should a creditor be forced to accept such an adjustment without his consent." H.R. Rep. No. 79-2246, at 4 (1946), J.A.411; *see also* H.R. Rep. No. 94-686, at 19 (1975), J.A.469; S. Rep. No. 95-989, at 110 (1978), J.A.508-09.

The parties agree that, at all times prior to 1984, this provision applied to Puerto Rico.

In 1984, Congress amended the Bankruptcy Code to add a definition of "State," which includes Puerto Rico and the District of Columbia "except for the purpose of defining who may be a debtor under Chapter 9 of [the Code]." 11 U.S.C. § 101(52).

Because Section 903(1) has nothing to do with this one excluded purpose (defining who may be a Chapter 9 debtor), the 1984 amendment did not vary, and indeed confirmed, Section 903(1)'s preemption of Puerto Rican (and District of Columbia) municipal composition laws. Nothing in the text or legislative history of the 1984 amendment suggests that the exclusion of Puerto Rico and Washington, D.C. from Chapter 9 lifted preemption and licensed these jurisdictions to enact identical or harsher versions of that chapter as their own law.

Both the First Circuit and the district court therefore held that Section 903(1) continues to apply to Puerto Rico and preempts its recently enacted Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act"), which no party disputes "prescribe[s] a method of composition of municipal indebtedness" binding non-consenting creditors. As the First Circuit observed, in a comprehensive opinion by Judge Lynch, its preemption ruling "follows straightforwardly from the [Bankruptcy Code's] plain text and is confirmed by both statutory history and legislative history." First Cir. Op., Commonwealth-Pet. App. at 31a.

Petitioners, the Commonwealth of Puerto Rico and officers of its Government Development Bank (the "GDB"), advance multiple interpretations of Section 903(1) in an effort to avoid that provision's preemptive bar. But as the First Circuit found, *id.*, each of their arguments for limiting Section 903(1) is "[c]reative [b]ut [u]nsound":

1. Petitioners contend that, when Congress in 1984 withdrew authorization for Puerto Rico and the District of Columbia to invoke Chapter 9, it also implicitly released them from Section 903(1)'s preemptive bar. But petitioners offer no support for this contention, other than a suggestion that it would be unfair for a debtor excluded from the "benefits" of Chapter 9 to bear its "burdens." As the First Circuit observed, construing the 1984 amendment to have effected a drastic transformation of Section 903(1) would violate the Court's teaching that Congress does

not make major changes to a regulatory scheme without clearly announcing its intention to do so.

2. Petitioners' alternative contention – that Section 903(1) has *always* contained an implicit exception for jurisdictions whose municipalities are "categorically ineligible" for Chapter 9 – fares no better.

a. Petitioners give principal weight to Section 903(1)'s location within Chapter 9 and its status as a "proviso" to Section 903's main clause. But neither warrants altering the plain meaning of Section 903(1)'s terms, which apply to the laws of *all* "States," regardless of whether their municipalities are eligible for Chapter 9. And the logic of petitioners' argument, if adopted, would authorize every state to enact its own municipal composition law, which any municipality could use so long as it did not commence a Chapter 9 case – a result that would eviscerate Section 903(1).

b. Petitioners contend that Section 903(1) was intended to "codify" a supposed "traditional rule" of bankruptcy preemption, under which states were free to enact their own municipal bankruptcy laws during times when no such federal remedy was available. But this supposed "traditional rule" is a fiction. For most of this country's history, municipalities had no recourse to bankruptcy law at *either* the state *or* the federal level. Congress was well aware of this history; it has repeatedly recognized the constitutional limitations on the states' powers to enact municipal

bankruptcy laws of their own. Indeed, respondents' complaint asserted those very limitations as reason to invalidate the Recovery Act on constitutional grounds, and the district court denied petitioners' motions to dismiss in the same decision that found the Recovery Act preempted by Section 903(1).

3. The GDB (though not the Commonwealth) advances a third interpretation, based on amendments to the Bankruptcy Code's definition of "creditor." But its contention that a municipality has no creditors, and therefore is not bound by Section 903(1), until it has commenced a Chapter 9 case tortures the statute's language and history. Like the "proviso" argument, this interpretation would transform Section 903(1) from a statute barring *all* state municipal composition laws into one permitting *any* state to enact such laws.

Lacking support in the statute's text, history and purpose, petitioners rely heavily on the "presumption against preemption." But no presumption against preemption is warranted here. The field of municipal bankruptcy has been occupied by federal law for almost 80 years and was never the province of state law. Petitioners' claims of a "no-man's land" are both legally irrelevant and factually unfounded. And Congress' decision to retain jurisdiction over the restructuring of Puerto Rico and D.C. municipal debt serves sound public policies.

Petitioners' contention that the First Circuit's construction of Section 903(1) "makes no sense,"

Commonwealth Br. 2, turns the truth on its head. What makes no sense is petitioners' contention that, by excluding Puerto Rico and the District of Columbia from Chapter 9, Congress licensed those jurisdictions to copy Chapter 9 and enact it as their own statute – a result that would nullify their exclusion from Chapter 9. Even more far-fetched is the claim that, by excluding Puerto Rico and D.C., Congress meant to give these *territories* a power it had withheld from the *States*: the power to enact a more onerous municipal composition law, such as the Recovery Act, thereby undermining Congress' longstanding prohibition of such state laws.

The Commonwealth's contention that it faces a fiscal crisis and therefore needs recourse to the Recovery Act to avert a potential shutdown of "vital public services" and a "race to the courthouse" is as unsupported as it is irrelevant. The *Commonwealth's* fiscal crisis has nothing to do with the Recovery Act, which applies only to PREPA and a few other government corporations, not to the Commonwealth itself. There is no danger of a shutdown of public services, because PREPA's trust agreement requires revenues to be used to pay operating expenses prior to any debt service payments. There is no danger of a race to the courthouse, because Puerto Rico law protects PREPA from seizure of assets by creditors.

The principal purpose of the Recovery Act is not to avert such illusory harms, but instead to avoid the appointment of a receiver, who would seek to increase

PREPA's base electrical rate – which has not been raised in 27 years, and which could readily be raised now given the 29% decline in PREPA's overall rates since the Recovery Act was passed.

ARGUMENT

I. THE PLAIN TEXT, HISTORY AND PURPOSE OF SECTION 903(1) MAKE CLEAR THAT CONGRESS INTENDED TO PREEMPT ALL STATE MUNICIPAL COMPOSITION LAWS

For almost seventy years, the federal bankruptcy laws have contained a provision expressly barring "State" laws that authorize non-consensual municipal compositions. *See* Act of July 1, 1946, ch. 532, § 83(i), 60 Stat. 409, 415, J.A.571. That provision is now codified in Section 903(1) of the Bankruptcy Code, which provides:

> This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but –
>
> (1) *a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition*; and

> (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

11 U.S.C. § 903 (emphasis added).[1]

The Bankruptcy Code, in turn, defines "State" to include Puerto Rico for all purposes but one:

> "State" includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under Chapter 9 of [title 11].

11 U.S.C. § 101(52).

The import of these two provisions is plain. Because Section 903(1) has nothing to do with "defining who may be a debtor under Chapter 9," the "State" laws that Section 903(1) prohibits include those of Puerto Rico. A contrary construction would violate the established maxim that, where Congress explicitly enumerates a single exception to a rule, additional exceptions should generally not be inferred. *See, e.g.*, *TRW Inc. v. Andrews*, 534 U.S. 19, 28 (2001).

As the First Circuit correctly found, the statutory history and legislative history of Section 903(1) confirm this interpretation.

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[1] A "composition" is an "agreement between a debtor and two or more creditors for the adjustment or discharge of an obligation for some lesser amount." *Black's Law Dictionary* 346 (10th ed. 2014).

Section 903(1) was first enacted in 1946, in largely identical language:

> (i) Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its political or governmental powers, including expenditures therefor: *Provided, however*, That no State law prescribing a method of composition of indebtedness of such agencies shall be binding upon any creditor who does not consent to such composition, and no judgment shall be entered under such State law which would bind a creditor to such composition without his consent.

Act of July 1, 1946, ch. 532, § 83(i), 60 Stat. 409, 415, J.A.571.

The provision was enacted to overrule *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), which had sustained a New Jersey municipal composition statute in the face of a challenge on preemption and Contract Clause grounds. *See* Hearings on H.R. 4307 Before the Special Subcomm. on Bankr. & Reorg. of the H. Comm. on the Judiciary, 79th Cong., at 10, 15-16 (1946) (statement of Millard Parkhurst) (describing amendment as overruling *Faitoute* to ensure that only federal law can impose compositions on non-consenting bondholders), J.A.431-32, 444-46.

The House Report on Section 83(i), as well as the Committee reports on all of that provision's successors, echoed this statement of the statute's purpose.

The 1946 House Report explained that "a bankruptcy law under which bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the 48 States, as the bonds of almost every municipality are widely held." H.R. Rep. No. 79-2246, at 4 (1946), J.A.411. Thus, the statute was intended to ensure that "[o]nly under a Federal law should a creditor be forced to accept . . . an adjustment without his consent." *Id.*

Congress subsequently retained the provision banning state municipal composition laws in two successive versions of the federal bankruptcy laws, enacted in 1976 and 1978. *See* Act to Amend Chapter IX of the Bankruptcy Act, Pub. L. No. 94-260, 90 Stat. 315, 316-17 (1976), J.A.581; Bankruptcy Reform Act of 1978, Pub. L. No. 95-598 (1978), 92 Stat. 2549, 2622, J.A.598. Each time, the House and Senate debated whether to retain the bar, with the House Bill deleting it and the Senate Bill retaining it. Each time, the Senate prevailed.[2]

---

[2] *See* H.R. Rep. No. 94-686, at 2, 19 (1975), J.A.449, 468-69 (explaining that House version deleted preemptive bar, while Senate version retained it "for the same reason it was enacted by Congress" in 1946); H.R. Rep. No. 94-938, at 16 (1976) (Conf. Rep.), J.A.482 (adopting Senate version over House version); S. Rep. No. 95-989, at 110 (1978), J.A.508-09 (explaining that Senate version retained preemptive bar); H.R. Rep. No. 95-595,

(Continued on following page)

With respect to Section 903(1) of the current Bankruptcy Code, the 1977 House Report argued for deletion of the provision:

> Section 903 is derived, with stylistic changes, from section 83 of current Chapter IX. . . . The proviso in section 83, prohibiting State composition procedures for municipalities, is deleted. In light of the recent Supreme Court case, *National League of Cities v. Usery*, 426 U.S. 833 (1976), maximum flexibility for the States in solving the debt problems of their municipalities is advisable.

H.R. Rep. No. 95-595 at 397-98 (1977), J.A.502.

The Senate Report argued for retention of the provision:

> The proviso in section 83, prohibiting State composition procedures for municipalities, is retained. *Deletion of the provision would 'permit all States to enact their own versions of Chapter IX', Municipal Insolvency, 50 Am. Bankr. L.J. 55, 65, which would frustrate the constitutional mandate of uniform bankruptcy laws.*

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at 397-98 (1977), J.A.502 (explaining that House version deleted preemptive bar); 124 Cong. Rec. 32,403 (1978) (statement of Rep. Edwards), J.A.512 ("To the extent section 903 of the House bill would have changed present law, such section is rejected."); 124 Cong. Rec. 34,002 (1978) (statement of Sen. DeConcini), J.A.521 (same).

S. Rep. No. 95-989, at 110 (1978), J.A.509 (emphasis added).

The Senate prevailed – the House amended its bill to adopt the Senate's position:

> Section 903 of the House amendment represents a stylistic revision of section 903 of the Senate amendment. To the extent section 903 of the House bill would have changed present law, such section is rejected.

124 Cong. Rec. 32,403 (1978) (statement of Rep. Edwards), J.A.512; 124 Cong. Rec. 34,002 (1978) (statement of Sen. DeConcini), J.A.521 (same).

In sum, Congress three times enacted statutes – in 1946, 1976, and 1978 – to preempt all state municipal composition laws, with near-identical legislative history each time expressly declaring that intent.

II. PETITIONERS' ATTEMPTS TO EXEMPT THE COMMONWEALTH FROM SECTION 903(1)'s UNQUALIFIED BAR LACK MERIT

Petitioners advance multiple constructions of Section 903(1) in an attempt to avoid that provision's unqualified preemptive bar. They contend that Congress' 1984 amendment, by withdrawing Puerto Rico and the District of Columbia's eligibility for Chapter 9, implicitly released them from the preemptive bar. Alternatively, they argue that Section 903(1) has always contained an implicit exception for jurisdictions whose municipalities are "categorically ineligible" for

Chapter 9. And the GDB (though not the Commonwealth) proffers a third interpretation: that Section 903(1) applies only to municipalities that have actually commenced a Chapter 9 case. The First Circuit properly rejected each of these arguments.

A. The 1984 Definition of "State" Did Not Exempt Puerto Rico from Section 903(1)'s Preemptive Scope

The parties agree that, at all times prior to 1984, Section 903(1) applied to Puerto Rico, as well as to all states and territories. *See, e.g.*, Commonwealth Br. 47; Petition of Melba Acosta-Febo, *et al.*, at 24; *see also* Amicus Br. of Profs. Gillette and Skeel at 6 ("From the earliest municipal bankruptcy laws until 1984, Puerto Rico municipalities were authorized to file for municipal bankruptcy.").

The original version of the provision, Section 83(i), applied to Puerto Rico as a "State," because the Bankruptcy Act defined that term to "include the Territories and possessions to which this Act is or may hereafter be applicable," *see* Act of June 22, 1938, ch. 575, § 1(29), 52 Stat. 840, 842, J.A.554, and the Bankruptcy Act was "applicable" to Puerto Rico, *see In re Vidal*, 233 F. 733, 737-38 (1st Cir. 1916) (noting applicability of national Bankruptcy Act in Puerto Rico).

The Bankruptcy Code as enacted in 1978 contained no definition of "State," but the term was assumed to include Puerto Rico[3] and the other territories. No party to this appeal has contended, here or in the courts below, that the lack of a definition from 1978 to 1984 excluded Puerto Rico from Section 903(1)'s bar.

Thus, the only question is whether the 1984 amendment to the Bankruptcy Code, by expressly excluding Puerto Rico's and the District of Columbia's municipalities from eligibility for Chapter 9, thereby effected an abrupt and drastic transformation of Section 903(1), excepting these jurisdictions from the scope of that section's preemptive bar.

Both courts below correctly concluded that the answer is "no." This amendment made no change to the text of Section 903. There is no legislative history to this 1984 amendment (as there was for contemporaneous amendments),[4] and thus no evidence of any Congressional intent to narrow Section 903(1)'s reach. The 1984 amendment made only one pertinent

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[3] *See Segarra v. Banco Central y Economias (In re Segarra)*, 14 B.R. 870, 872-73 (Bankr. D.P.R. 1981).

[4] The amendment inserting the new definition of "State" in 11 U.S.C. § 101(52) was one of numerous amendments in 1984. There is extensive legislative history relative to the other amendments, which included highly controversial provisions relating to Article III jurisdiction and the power to terminate collective bargaining agreements, but neither the other amendments nor their legislative history is in any way relevant to this case. We therefore refer to Section 101(52) as ***the*** 1984 amendment.

change: the addition of a definition of "State," which included Puerto Rico and the District of Columbia "except for the purpose of defining who may be a debtor under Chapter 9 of this title." 11 U.S.C. § 101(52).

Section 109(c) defines "who may be a debtor" under Chapter 9. Thus, the exclusion of Puerto Rico from the definition of State "for the purpose of defining who may be a debtor under Chapter 9" affects only Section 109(c)(2). For purposes of all *other* provisions of the Bankruptcy Code, including Section 903(1), Puerto Rico falls within Section 101(52)'s definition of "State." Section 903(1) continued to apply to Puerto Rico after the 1984 amendment, just as it had at all times since its enactment in 1946.

As the First Circuit observed, a contrary reading of the 1984 amendment – so as to exclude Puerto Rico from the reach of Section 903(1) – would contravene not only the plain language of Section 101(52), but also the cardinal rule that Congress will not be presumed to have made major changes to a statute unless it has clearly announced its intent to do so. First Cir. Op., Commonwealth-Pet. App. at 26a-28a. "Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions – it does not, one might say, hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001); *see also Kellogg Brown & Root Servs., Inc. v. U.S. ex rel. Carter*, 135 S. Ct. 1970, 1977 (2015) ("Fundamental changes in the scope of a statute are not typically accomplished with so subtle

a move."); *United Savings Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 380 (1988) ("Such a major change in the existing rules would not likely have been made without specific provision in the text of the statute; it is most improbable that it would have been made without even any mention in the legislative history.") (internal citation omitted).

The exclusion of Puerto Rico from Section 903(1)'s longstanding preemptive bar is exactly the sort of elephant that Congress would not have hidden in the mousehole of its 1984 definition of "State," with no change to the text of Section 903(1) and no indication in the legislative history of any intention to modify the scope of that bar. This is fatal to petitioners' position, as both courts below held.

Indeed, as noted in Point I above, Congress between 1976 and 1978 had debated whether or not to retain Section 903(1), before ultimately deciding to retain the preemptive bar. The notion that Congress made a sweeping change to Section 903(1)'s scope in 1984 without any comment is particularly hard to credit when the issue of whether to keep Section 903(1) had been debated extensively and decided by Congress just a few years earlier.

The Commonwealth thus has it backwards when it argues that it is "anomalous in the extreme to think that Congress – *sub silentio* and through an amendment to a statutory definition – foreclosed Puerto Rico from access to any legal mechanism for restructuring the debts of its public utilities." Commonwealth Br. 2;

see also id. at 3 (Congress "could hardly have chosen a more roundabout means of doing so"). Congress acted on two separate occasions to exclude Puerto Rico from access to municipal composition laws – in 1946, when it barred Puerto Rico from enacting its own municipal composition laws, and in 1984, when it excluded Puerto Rico's municipalities from access to Chapter 9. Each time, Congress' action was direct and explicit, not "roundabout." It is petitioners, not respondents, that ask the Court to conclude that Congress effected a partial repeal of longstanding law – Section 903(1)'s express prohibition of state municipal composition laws – "*sub silentio* and through an amendment to a statutory definition." Commonwealth Br. 2.

B. Section 903(1) Contains No Exception for Jurisdictions Ineligible for Chapter 9 Relief

As an alternative to contending that the 1984 amendment implicitly amended Section 903(1), petitioners claim that amendment triggered an exception that had *always* been implicit in Section 903(1): an exception for jurisdictions, like Puerto Rico and the District of Columbia, whose municipalities are "categorically ineligible" for Chapter 9. Commonwealth Br. 12, 25; *see also* GDB Br. 17, 27.

Petitioners advance a variety of supposed bases for this conclusion: that Section 903(1) is located in Chapter 9 and operates merely as a "proviso" to a provision in that chapter; that a fragment of the

legislative history suggests that Congress intended to limit Section 903(1)'s scope; and that Section 903(1) "codified" a "traditional rule" under which municipalities had been free to restructure their debts under state law whenever no federal law alternative existed. Each of these contentions is weightless.

i. The Location of Section 903(1) Provides No Basis for Limiting That Provision's Preemptive Bar

The Commonwealth contends that the First Circuit failed to read Section 903(1) in its proper statutory context: as "a proviso to a provision, Section 903, that does not apply to Puerto Rico, located within a chapter of the Code, Chapter 9, that does not apply to Puerto Rico." Commonwealth Br. 12; *see also id.* at 23-24. This context, the Commonwealth claims, reflects Section 903's purpose of "preventing Chapter 9 from intruding into a core area of state autonomy." *Id.* at 24. It supposedly follows, "as a matter of law and logic," that Congress did not mean Section 903(1) to apply to jurisdictions whose municipalities are "categorically ineligible" for Chapter 9. *Id.* at 12, 25, 42.

This attempt to read an unwritten exception into Section 903(1) fails for multiple reasons.

1. The interpretation is defeated by the plain language of Sections 903(1) and 101(52). Section 903(1) bars *all* "State" laws that bind non-consenting creditors to municipal debt compositions; it contains no

exception for States ineligible to employ Chapter 9. Section 101(52) is equally plain: It defines Puerto Rico as a State for *all* purposes except Chapter 9 eligibility.

2. Petitioners' interpretation also contravenes Section 903(1)'s purpose: to ensure that "[o]nly under a Federal law should a creditor be forced to accept such an adjustment without his consent." H.R. Rep. No. 79-2246, at 4 (1946), J.A.411.

3. In addition, the Commonwealth's contention proves too much. The logic of the argument, if adopted, would exempt from Section 903(1)'s scope not only Puerto Rican and D.C. law, but *any* state municipal composition law, which any municipality could use so long as it did not commence a Chapter 9 case. A municipality that restructures its debts under state law is not using a federal law (Chapter 9), and consequently is not "intruding into a core area of state autonomy" – the sole evil petitioners say Section 903 was designed to prevent, Commonwealth Br. 24; *see also* GDB Br. 27 ("As expressed in its title – 'Reservation of State power to control municipalities' – the purpose of § 903 is to preserve a state's powers over its municipalities in the face of a Chapter 9 proceeding."). As discussed in Point II.C below, this construction – like the GDB's "creditor" construction – would make Section 903(1) a dead letter.

4. Even if the Commonwealth's argument were taken at face value – so as to carve out from Section 903(1) only state laws for municipalities

"categorically ineligible" for Chapter 9 – this construction still would eviscerate Section 903(1). The Bankruptcy Code requires a municipality to obtain the authorization of its state to file under Chapter 9. 11 U.S.C. § 109(c)(2). Any state could withhold access to Chapter 9 (as 24 states have already done),[5] enact its own state municipal composition law, and then argue, like petitioners, that Section 903(1) does not bind them because they are "categorically ineligible" to employ Chapter 9.[6]

5. Section 903(1) should not be construed in such a nonsensical fashion, regardless of whether it is deemed to be a "proviso." When, as here, a statute's text and purpose indicate that Congress intended a proviso to have independent force, it will be so construed. *Republic of Iraq v. Beaty*, 556 U.S. 848, 858 (2009) (a proviso may be used "to state a general, independent rule") (citations omitted); *Alaska v. United States*, 545 U.S. 75, 106-08 (2005) (a proviso can operate "affirmatively and independently" rather than "negatively and parasitically"); *McDonald v. United States*, 279 U.S. 12, 21-22 (1929) (in interpreting

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[5] *See* Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. Chi. L. Rev. 281, 296-97 (2012).

[6] Petitioners fail to explain how, if Chapter 9 does not "apply" in Puerto Rico (and the District of Columbia) because municipalities of those jurisdictions cannot currently seek Chapter 9 relief, Chapter 9 would "apply" in states that can but have chosen not to authorize Chapter 9 relief. *See* Commonwealth Br. 3.

proviso, "the general purpose of the section may be taken into account"); *Ga. R.R. & Banking Co. v. Smith*, 128 U.S. 174, 181 (1888) (even the term "provided" can sometimes be read as "having no greater signification than would be attached to the conjunction 'but' or 'and' in the same place, and simply serving to separate or distinguish the different paragraphs or sentences").

Moreover, it would make no sense to read Section 903(1) as an exception to the main clause of Section 903, since the two clauses deal with different subjects. The main clause specifies what "[t]his chapter" does not do (a limitation on *federal* power), while Section 903(1) specifies what a "State law" may not do (a limitation on *state* power).

6. Nor does the location of Section 903(1) within Chapter 9 warrant giving it a construction that is both counter-textual and senseless. While a provision's location can be relevant to a determination of its meaning, the Court "hesitate[s] to place too much significance on the location of a statute in the United States Code." *Jones v. R.R. Donnelley & Sons Co.*, 541 U.S. 369, 376 (2004); *see also Bhd. of R.R. Trainmen v. Balt. & O.R. Co.*, 331 U.S. 519, 527 (1947) (subsection of Interstate Commerce Act granting union right to intervene in "any proceeding arising under this Act" referred to both administrative and judicial proceedings, notwithstanding that subsection was located in a section of the statute in which at least ten of the twelve paragraphs dealt with administrative proceedings).

Moreover, the location of Section 903(1) makes perfect sense. Chapter 9 – the chapter of the Bankruptcy Code applicable to municipalities – is the natural place to put a provision limiting state law relating to municipal bankruptcy.[7]

Congress' decision to place the provision within Section 903 specifically also makes sense, when the historical context is considered. As noted above, Congress added Section 83(i) (Section 903(1)'s predecessor) in response to the Supreme Court's *Faitoute* decision, which had held that some state municipal restructuring laws were neither preempted by the Bankruptcy Act nor barred by the Contract Clause. Because *Faitoute* had relied on Section 83(i) to support its non-preemption holding, *see* 361 U.S. at 508, it was natural for Congress to overrule *Faitoute* by amending Section 83(i), thereby addressing in one place both the area of autonomy preserved to the states and the new proscription on state conduct.[8]

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[7] Multiple Bankruptcy Code provisions, like Section 903(1), apply whether or not a case under the Code is pending. *See, e.g.*, 11 U.S.C. § 528 (imposing regulations on debt relief agencies); *id.* § 525 (prohibiting discriminatory treatment of former debtors); *id.* § 362(a)-(b) (making automatic stay applicable to proceedings under the Securities Investor Protection Act).

[8] Contrary to the Commonwealth's contention, Commonwealth Br. 24, the title of Section 903 also is a poor guide to its meaning. "[T]he title of a statute and the heading of a section cannot limit the plain meaning of the text." *Bhd. of R.R. Trainmen*, 331 U.S. at 528-29. This is particularly true where, as

(Continued on following page)

ii. The Legislative History Provides No Basis for Limiting Section 903(1)'s Preemptive Bar

Petitioners claim to find additional support for their proposed ineligible-jurisdictions exception in language from an early, unenacted version of Section 83(i), under which the preemptive bar would have applied only "while this chapter is in effect." *See* GDB Br. 38; *see also* Commonwealth Br. 51.[9] They suggest that Congress assumed states would be free to legislate in the area if and when they no longer had access to Chapter 9.

This argument cannot withstand scrutiny. *First*, Congress did not pass the bill on which petitioners rely. That unenacted bill is entitled to little, if any, weight. *See, e.g.*, *Mead Corp. v. Tilley*, 490 U.S. 714, 723 (1989) ("We do not attach decisive significance to the unexplained disappearance of one word from an unenacted bill because 'mute intermediate legislative maneuvers' are not reliable indicators of congressional intent.") (citation omitted).

Second, as discussed in Point II.B.iii below, Congress has repeatedly taken note – both before and

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here, the "under-inclusiveness of the [headings] . . . is apparent." *Lawson v. FMR LLC*, 134 S. Ct. 1158, 1169 (2014).

[9] The GDB references the unenacted version of the statute directly, *see* GDB Br. 38, and the Commonwealth cites Congressional testimony regarding that original version, *see* Commonwealth Br. 51.

after 1946 – of the stringent limits placed on the States' powers to impair state and municipal bond debt by this Court's Contract Clause jurisprudence.

Third, the text and stated purpose of the statutory provisions that Congress did enact, Sections 903(1) and 101(52), are clear. As noted, Section 903(1) by its plain terms bars *all* "State" municipal composition laws, with no exception for jurisdictions that are or might one day be ineligible for Chapter 9. Moreover, the House Report for Section 83(i) made clear that Congress' objective was not merely, as petitioners would have it, to bar states with access to Chapter 9 from enacting their own municipal composition laws, but rather the broader goal of barring *all* such state laws. H.R. Rep. No. 79-2246, at 4 (1946), J.A.411.

Even more telling is the action Congress took in 1984. In 1946, when Congress first enacted Section 903(1)'s predecessor, all States and territories were covered by Chapter 9, and there was therefore no need for Congress to decide whether, if it subsequently excluded a particular jurisdiction from that chapter's coverage, it would also want to exclude that jurisdiction from the predecessor to Section 903(1).

In 1984, by contrast, Congress excluded Puerto Rico and D.C. from eligibility for Chapter 9, but wrote no words that excluded them from the preemption of Section 903(1). To the contrary, the language of new Section 101(52) defined "State" to include Puerto Rico and D.C. for *all purposes except* "defining who may be

a debtor under Chapter 9 of [title 11]." 11 U.S.C. § 101(52).

These words can be read only one way: Puerto Rico and D.C. *are* States for purposes of Section 903(1). Had Congress meant to exempt Puerto Rico and D.C. from Section 903(1), it easily could have written § 101(52) to exclude Puerto Rico as a State "with respect to all provisions in Chapter 9," instead of merely excluding them "for the purpose of defining who may be a debtor" in Chapter 9. *See* First Cir. Op., Commonwealth-Pet. App. at 28a.

iii. The History of the Municipal Bankruptcy Laws Provides No Basis for Limiting Section 903(1)'s Preemptive Bar

The GDB contends that Section 903(1) "codified" a supposed "traditional rule" of bankruptcy preemption for municipalities, under which states historically were free to enact their own municipal bankruptcy laws whenever Congress had not occupied that field. GDB Br. 34-40; *see also* Commonwealth Br. 18-19.

The GDB is wrong. For most of this country's history, municipalities had no recourse to state *or* federal bankruptcy law. Congress repeatedly acknowledged the states' limitations in this area and never assumed that, absent Congressional action, the states could fill the gap.

1. Prior to the 1930s, few state statutes – and no federal statutes – purported to impair municipal bond contracts. Those state statutes that did attempt such relief were repeatedly struck down as violative of the Contract Clause. *See, e.g.*, *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935); *Louisiana v. Pilsbury*, 105 U.S. 278 (1881); *see also U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 24, n.22 (1977) ("State laws authorizing the impairment of municipal bond contracts have been held unconstitutional."); A.M. Hillhouse, *Municipal Bonds: A Century of Experience* 352 (1936) (cited in GDB Br. 24) ("States . . . are powerless to effect compromises of bonds and other obligations outstanding, except in those instances where all creditors approve (and these are rare)."); Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 450-51 (1993) (States were unable to remedy hold-out problem because "forcing an unwilling creditor to compromise his claim would be an unconstitutional impairment of the obligation of contract").

The Great Depression increased the need for municipal debt relief and led to legislative responses at both the federal and state levels. In 1934, Congress passed the first federal municipal bankruptcy law, Chapter IX of the Bankruptcy Act. Act of May 24, 1934, ch. 345, 48 Stat. 798. The Court struck down that statute two years later, in *Ashton v. Cameron County Water Improvement District No. One*, 298 U.S. 513 (1936), on the ground that it impermissibly

interfered with state sovereignty. *Id.* at 531-32. The next year, Congress responded by passing a largely identical statute, Act of August 16, 1937, ch. 657, 50 Stat. 653, J.A.546; *see* McConnell & Picker, 60 U. Chi. L. Rev. at 452 (noting that this statute was "only slightly different from the invalidated one").

In 1938, the Court upheld this new statute. *United States v. Bekins*, 304 U.S. 27, 54 (1938). But the Court continued to hold that state impairment of municipal bond contracts violated the Contract Clause. Indeed, *Bekins* sustained the 1937 Act in part on the ground that the states were without power to grant similar relief: "The natural and reasonable remedy through composition of the debts of the district was not available under state law by reason of the restriction imposed by the Federal Constitution upon the impairment of contracts by state legislation." *Id.* at 53-54.

In 1942, the Court for the first time relaxed, but did not remove, the Contract Clause's prohibition on state municipal restructuring laws. In *Faitoute*, the Court upheld the constitutionality of a New Jersey municipal debt restructuring statute, holding that it was neither barred by the Contract Clause nor preempted by Congress' recent municipal bankruptcy statute. 316 U.S. at 508-09, 515-16. As noted, Congress responded promptly, enacting Section 903(1) in 1946 for the specific purpose of barring all municipal composition laws.

Nevertheless, *Faitoute* had lifted the Contract Clause bar to state municipal bankruptcy laws only slightly. Justice Frankfurter's opinion was careful to note that the statute at issue was limited: it affected only unsecured, not secured, debt; it required 85% creditor consent; and it specifically prohibited the reduction of principal, permitting only the extension of maturities and the reduction of interest. 316 U.S. at 504, 509-10. Moreover, as the Court's opinion emphasized, this limited impairment of bondholders' contractual rights actually benefitted the affected bondholder class and increased the value of their bonds because, as unsecured creditors, they had no meaningful remedies against the city. *Id.* at 513, 515-16. The Court considered this point determinative, giving decisive weight to the fact that the statute at issue took a "most depreciated claim of little value" and "saved and transmuted [it] into substantial value." *Id.* at 515-16.[10]

The Recovery Act goes far beyond what *Faitoute* permitted. It authorizes the reduction in principal of secured bondholder claims over the unanimous dissent of those bondholders – a power never before asserted by any state or territory. Specifically, the Recovery Act requires a debt enforcement plan to separate "affected debt" into classes for purposes of voting on approval or rejection of the plan, Recovery

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[10] By contrast, respondents here have the remedy of a receiver – or at least, they had such a remedy before Puerto Rico's preempted statute purported to eliminate it.

Act § 315, and it permits the court to impose the plan on a class of dissenting secured creditors so long as at least one *other* creditor class votes in favor of the plan. Recovery Act §§ 312, 315.

To this day, no state has the power to authorize such a severe impairment of municipal bondholders' rights. The states' powers remain subject to substantial constitutional limitations – much more so than either *federal* impairments of municipal debt or state impairments of *private* debt. The Court emphasized the distinction between impairments of private and government debt in its 1977 decision striking down a New Jersey statute as an unconstitutional impairment of bondholders' contractual rights, *U.S. Trust Co. of N.Y. v. New Jersey*. 431 U.S. 1 (1977). The Court stressed the narrowness of *Faitoute*'s holding, noting that the restructuring upheld there had caused a sharp increase in the market value of the bonds, 431 U.S. at 28, and also that *Faitoute* represented "[t]he only time in this century that alteration of a municipal bond contract has been sustained by this Court." *Id.* at 27; *see also Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 410-13 (1983) (comparing stringent standard of review for state impairments of government debt with less demanding standard applicable to impairments of private debt). As petitioners' *amici* acknowledge, state municipal debt restructuring laws would continue to be constrained by these Contract Clause restrictions – and consequently "would have a more limited scope than Chapter 9" – even if they were not barred by

Section 903(1). Amicus Br. of Profs. Gillette and Skeel at 14.

2. Congress was fully aware of the limitations imposed on the states by virtue of the Contract Clause. Congress repeatedly stated – both before and after *Faitoute* – that it was acting in the area of municipal bankruptcy precisely because it did not believe the States had the power to provide a sufficient remedy.

In 1934, the Senate Judiciary Report accompanying the statute that was struck down in *Ashton* explained that, in light of constitutional limitations, "the States do not possess the power necessary effectively to deal with the situation which exists with regard to bankrupt taxing districts." S. Rep. No. 73-407, at 1-2 (1934), J.A.325. Similarly, the 1937 House Report issued in connection with the re-enactment of Chapter IX stated:

> There is no hope for relief through statutes enacted by the States, because the Constitution forbids the passing of State laws impairing the obligations of existing contracts. Therefore, relief must come from Congress, if at all.

H.R. Rep. No. 75-517, 3-4 (1937), J.A.392.

In 1976, when Congress revised the municipal bankruptcy laws, it again reiterated its view that States had only limited power to act in the area. The House initially proposed deleting the predecessor to Section 903(1). H.R. Rep. No. 94-686, at 2, 19 (1975), J.A.449, 468-69. But this was not because it believed

State bankruptcy legislation would fill the gap. To the contrary, the House Report explained that:

> Though it is desireable [sic] to have a procedure that adjusts the rights of security holders be uniform throughout the country, the Committee feels that the Contracts Clause of the Constitution places such close restrictions on what the States may accomplish through their own composition procedures, that any nonuniformity that might result from the deletion of the restriction would be minimal and would not outweigh the interests of the States in the management of their own fiscal affairs, where they are able to manage effectively without the aid of a Federal municipal adjustments statute.

Id. at 2, J.A.449. The same 1975 House report also quoted with approval the legislative history of the 1937 bankruptcy act, set forth above, and noted that the "need for and the purpose of the bill have remained unchanged in the 42 years since the first Municipal Bankruptcy Act was passed." *Id.* at 4, J.A.452.

As noted in Point I above, the Senate disagreed with the House, insisting on the reinsertion of Section 83(i)'s proviso preempting state composition laws; prevailed over the House when the 1976 Amendments were passed; and prevailed again in the current Bankruptcy Code.

As this history makes clear, Congress did not believe – either when it enacted Section 903(1)'s

predecessors or later – that the States were free to enact their own laws providing for non-consensual composition of municipal debts. Whatever lesser forms of relief may have been within the States' power, Congress did not legislate on the assumption that, if and when Chapter 9 became inapplicable, an identical (or worse) State law could fill the gap.

3. The Commonwealth's "traditional rule" or "residual powers" argument is based on deference to the residual legislative and sovereign powers of the *states*. The states are for constitutional purposes the senior entities of the Republic, whose powers predated those granted to the federal government and are limited only by powers they or the people have ceded to the federal government under the Constitution. These concepts have no bearing on the interpretation of a federal statute that by its terms applies only to two *territories*.

In particular, petitioners' argument that Section 101(52) must be interpreted to respect an alleged "traditional rule" of state law ignores the fact that the Commonwealth has only those powers delegated to it by Congress under the Federal Relations Act of 1950, ch. 446, 64 Stat. 319 – a statute enacted only four years after Congress preempted all state and territorial municipal composition laws. Not only is there no "tradition" of state or territorial law regulating municipal compositions; there could be no "tradition" of any such Puerto Rican law, because Puerto Rico obtained full self-government only after Congress had

deprived all states and territories of the power to enact such laws.

4. Outside the municipal bankruptcy context, petitioners assert that states "have been enacting and enforcing bankruptcy statutes for over two hundred years." GDB Br. 21; *see also* Commonwealth Br. 16-17. This assertion has no relevance in the face of Section 903(1)'s unique and explicit preemption of state law, nor any relevance to the disproved argument that states have traditionally enacted municipal bankruptcy laws. Even on its own terms, the assertion is subject to question.

The eighteenth and nineteenth century statutes cited by petitioners bear little resemblance to the comprehensive restructuring regimes provided by the Bankruptcy Code and the Recovery Act.[11] Moreover, whatever the validity of state laws imposing moratoriums, extending maturities or granting other limited

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[11] None of the statutes contemplate municipal debtors, and Nevada's 1881 statute is the only law that acknowledges corporate debtors – in a provision that makes corporate debtors *ineligible* to obtain a discharge. 1881 Nev. Rev. Stat. ch. 97, § 48. These statutes focus in large part on issues unique to natural persons, such as the phenomenon of debtors' prisons. *See* Acts of the General Assembly of Pennsylvania 1814, ch. 3926 § 18 (releasing from prison persons confined for more than 30 days due to civil judgments of less than fifteen dollars); Laws of the Territory of Michigan 336 (1827) (eliminating practice of incarcerating women as means of executing on a civil judgment). Nothing in the laws cited by petitioners suggest anything like a corporate, much less a municipal, debt restructuring regime.

forms of debt relief, this Court has consistently held that "the Contract Clause prohibits the States from enacting debtor relief laws which *discharge* the debtor from his obligations. . . ." *See Ry. Labor Execs. Ass'n v. Gibbons*, 455 U.S. 457, 472 n.14 (1982) (emphasis added); *Stellwagen v. Clum*, 245 U.S. 605, 615 (1918) ("It is settled that a state may not pass an insolvency law which provides for a discharge of the debtor from his obligations. . . ."); *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 188 (1902) ("[Congress' power under the Bankruptcy Clause] includes the power to discharge the debtor from his contracts and legal liabilities. . . . The grant to Congress involves the power to impair the obligation of contracts, and this the States were forbidden to do.").

The Recovery Act imposes a permanent injunction on the collection of debt – that is, a discharge. *See* Recovery Act §§ 115(b)-(c), 315(k), Commonwealth-Pet. App. 187a-189a, 237a-239a; *see also* GDB Br. 12 (acknowledging that Recovery Act contains a discharge). But there is no history of state law discharges, much less state law discharges of municipal debt. Petitioners cannot save the Recovery Act from preemption under Section 903(1) by appealing to a "history of legislation" that does not exist.

5. Petitioners contend that Congress' historical exclusion of banks and insurance companies from the federal Bankruptcy Code shows tolerance for comprehensive state insolvency laws. Commonwealth Br. 18-19; GDB Br. 21. The contention is both inapposite and irrelevant.

It is inapposite because, unlike municipalities, banks and insurance companies had long been subject to liquidation under state regulatory schemes, which is why they were excluded from the Bankruptcy Code pursuant to 11 U.S.C. § 109(b)(2). *See* S. Rep. No. 95-989, at 31 (1978) (explaining exclusion).[12]

It is irrelevant because, whereas Congress expressly preempted state municipal composition laws under Section 903(1) and its predecessors, it has never taken such action with respect to state bank and insurance company statutes. To the contrary, Congress made clear that state laws authorizing the restructuring of banks and insurance companies were permitted and, in some instances, "reverse-preempted" federal law. *See, e.g.*, 15 U.S.C. § 1012 (preserving state authority over "the business of insurance"); 12 U.S.C. § 25b (state consumer finance laws); *id.* § 1465 (savings associations); *see generally Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585, 595 (5th Cir. 1998) ("Congress has evinced a strong federal policy in favor of deferring to state regulation of insolvent insurance companies . . . [including] the

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[12] Because insurance was long understood not to involve interstate commerce, states "enjoyed a virtually exclusive domain over the insurance industry." *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 538-39 (1978). When a 1944 Supreme Court decision changed that understanding, Congress swiftly cabined its effects by passing a law to preserve state authority over insurance regulation. *Id.* at 539; *see* 15 U.S.C. § 1012.

express exclusion of insurance companies from the federal Bankruptcy Code.").

C. The Bankruptcy Code's Definition of "Creditor" Does Not Vitiate Section 903(1)'s Stated Purpose

The GDB (though not the Commonwealth) attempts to supply a textual basis for petitioners' novel construction of Section 903(1), contending that the Bankruptcy Code's definitions of the terms "creditor" and "debtor" radically limit Section 903(1)'s reach. GDB Br. 31-33. The First Circuit properly rejected this strained construction. First Cir. Op., Commonwealth-Pet. App. at 32a-36a; *see also City of Pontiac Retired Employees Ass'n v. Schimmel*, 751 F.3d 427, 431 (6th Cir. 2014) ("The plain language of this section is not limited to bankruptcy proceedings.").

The starting point for the GDB's argument is that Section 903(1) applies only to laws that purport to bind "creditors." GDB Br. 31. The Bankruptcy Code defines "creditor" as an "entity that has a claim against the debtor," 11 U.S.C. § 101(10)(A), and defines "debtor" as a "person or municipality concerning which a case under [title 11] has been commenced," 11 U.S.C. § 101(13). According to the GDB, the upshot of these provisions is that, until a Chapter 9 case has been commenced (giving rise to a "debtor"), no "creditors" exist, and therefore Section 903(1)'s prohibition does not apply. GDB Br. 32. In other words, Section 903(1) applies only to those municipalities that have

actually commenced a Chapter 9 case, and States are free to enact municipal restructuring laws so long as those laws do not bind creditors *in a Chapter 9 case*.

1. A reading of Section 903(1) that confined its application to Chapter 9 cases – *i.e.*, that read it to provide merely that State composition laws do not bind creditors *in a Chapter 9 case* – would make little sense. A municipality that has already commenced a Chapter 9 case has no need to employ state composition laws. Consequently, under petitioners' reading, Section 903(1) would have no effect except in the rare instance of a serial filer – a municipality that initially restructures its debts under a state composition law and then subsequently files a Chapter 9 case. Indeed, petitioners argued to the First Circuit that this was the sole purpose that Congress intended Section 903(1) to have. *See* GDB CA1 Br. (3/16/15) [No.15-1218], at 38-40. No basis exists for such a radical limitation of Section 903(1)'s scope.

2. As the First Circuit noted, the GDB's argument not only tortures the statutory language; it also "proves too much." First Cir. Op., Commonwealth-Pet. App. at 32a. If adopted, it would vitiate the provision's undisputed purpose: to bar states from passing their own municipal composition laws. *See* GDB CA1 Br. (3/16/15) [No.15-1218], at 46 (acknowledging that Section 903(1) was enacted in response to the "specter of every state passing its own version of Chapter 9"). Any state would be free to enact its own municipal composition statute, which its municipalities would be free to employ as an alternative to Chapter 9.

It is clear from the above-quoted debate between the House and Senate in 1976-78 that Congress viewed Section 903(1) to apply outside of Chapter 9 and to bar state laws whether or not a Chapter 9 case had commenced. The House would not have been concerned about states' rights if Section 903(1) applied only in a Chapter 9 case, because any state could choose not to authorize Chapter 9 cases at all. Nor would the Senate have insisted (successfully) on the retention of Section 903(1) to assure uniform application of federal law if that section applied only in a pending Chapter 9 case.

If the GDB's construction of Section 903(1) were adopted, this purpose would be completely undermined – not just in Puerto Rico, but nationwide. Any state would be free to enact its own municipal composition statute, which its municipalities would be free to employ as an alternative to Chapter 9, thereby gutting Congress' intended bar on state municipal composition statutes.

While the GDB attempts to limit the reach of its "creditor"/"debtor" argument to Puerto Rico and the District of Columbia on the ground that their municipalities can never be debtors, *see* GDB Br. 33, the argument's textual logic applies to all jurisdictions. If no "creditors" exist in the absence of a Chapter 9 "debtor," then Section 903(1) can never apply outside of a Chapter 9 case. 11 U.S.C. § 101(10)(A).

2. When rigid application of a statutory definition would nullify the statute's main purpose, courts

employ the term's ordinary, rather than its defined, meaning. *See Lawson v. Suwannee Fruit & S.S. Co.*, 336 U.S. 198, 201 (1949); *see also Philko Aviation, Inc. v. Shacket*, 462 U.S. 406, 412 (1983) (statutory definition should not be applied to "defeat the purpose of the legislation").

Adopting the ordinary meaning of "creditor" makes particular sense here, because, as the First Circuit noted, the Bankruptcy Code frequently uses the term "creditor" in accordance with its ordinary, rather than its defined, meaning. *See* First Cir. Op., Commonwealth-Pet. App. at 34a-36a, n.28.

For instance, while the GDB notes that "creditor" is defined as an entity that holds a claim "that arose at the time of or before the *order for relief* concerning the debtor," GDB Br. 32 (emphasis added), an "order for relief" is entered in a Chapter 9 case only *after* the court finds that the municipality is eligible for Chapter 9. *See* 11 U.S.C. § 921(c)-(d). To satisfy the eligibility requirements, a municipality must show, among other things, that it (i) "has obtained the agreement of *creditors*," (ii) "has negotiated in good faith with *creditors*," (iii) "is unable to negotiate with *creditors*," or (iv) "reasonably believes that a *creditor* may attempt to obtain a [preference]." 11 U.S.C. § 109(c)(5)(A)-(D) (emphasis added). A "creditor" for purposes of these provisions cannot be limited to an entity holding a claim "that arose at the time of or before the order for relief," because at the time a bankruptcy court is addressing Chapter 9 eligibility, there will not have been – and may *never* be – an

order for relief. Thus, for purposes of eligibility for Chapter 9, mechanical application of the definition of "creditor" would yield an absurd result: a putative municipal debtor would always satisfy the "unable to negotiate with creditors" prong of § 109(c)(5) because there would never be any "creditors" with which it could negotiate in advance of the entry of an order for relief. *See* First Cir. Op., Commonwealth-Pet. App. 35a, n.28.

Chapter 15 of the Bankruptcy Code provides another example. Chapter 15 permits an administrator in a foreign insolvency proceeding to seek recognition of the proceeding in the United States. *See* 11 U.S.C. §§ 1504, 1515. Upon recognition, the foreign representative may – or may not – choose to file a petition commencing a Chapter 7 or 11 case. *See* 11 U.S.C. §§ 1511(a), 1528. If it does not, there will be no "order for relief" because there is no "order for relief" in a case under only Chapter 15. *See* 11 U.S.C. § 103(a) (listing discrete sections of the Code that apply in Chapter 15, and not listing Section 301(b), which defines "order for relief"). If the GDB's construction is applied, there would never be any "creditors" in a case under only Chapter 15. Yet Chapter 15 grants a number of protections to "creditors" simply upon the filing of a Chapter 15 case, without need for entry of an order for relief. *See* 11 U.S.C. §§ 1513(a), 1519(a), 1521(a). Under petitioners'

reading of "creditor," the protections of these sections would be wholly illusory in many cases.[13]

In the words of the Court of Appeals:

> The Code is replete with use of the term "creditor" in ways not limited by the statutory definition on which defendants rely. For example, § 502(a) uses creditor in a manner that is expressly inconsistent with the statutory definition because "a creditor of a general partner in a partnership that is a debtor" is not, itself, a holder of a "claim against the debtor" and so not a "creditor" under § 101(10)(A). *See* 11 U.S.C. § 502(a) ("A claim [or] interest . . . is deemed allowed, unless a party in interest, *including a creditor of a general partner* in a partnership that is a debtor in a case under Chapter 7 . . . objects." (emphasis added)).
>
> Similarly, § 101(12A)(C) also uses "creditor" in a manner that is expressly inconsistent with § 101(10)(A). That provision, which defines "debt relief agency" to be "any person who provides any bankruptcy assistance to an assisted person, . . . " excludes "a creditor of such an assisted person."

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[13] Section 1501(b)(4) of the Bankruptcy Code also specifies that Chapter 15 "applies where . . . *creditors* or other interested persons in a foreign country have an interest in requesting the commencement of . . . a case or proceeding under [title 11]." 11 U.S.C. § 1501(b)(4) (emphasis added). Prior to commencement of a case under title 11, there are no "creditors" under petitioners' strict construction of the term.

> 11 U.S.C. § 101(12A)(C). But because an "assisted person" might never file for bankruptcy (presumably one of the goals of the agency), an "assisted person" might never become a debtor. "Creditor" here must have its plain meaning.
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> * * *
>
> [O]ther provisions of the Bankruptcy Code that use the term "creditor" expressly contemplate that there are "creditors" though there may never be an "order for relief." *See, e.g.*, 11 U.S.C. § 303(c) ("After the filing of a petition . . . but before the case is dismissed *or* relief is ordered, a *creditor* holding an unsecured claim . . . may join in the petition. . . .").

First Cir. Op., Commonwealth-Pet. App. 34a-36a, n.28.

3. The statutory history of the bankruptcy laws also confirms that Congress intended to use "creditor" in its ordinary sense here. When Congress enacted Section 903(1)'s predecessor in 1946 (as part of Section 83(i) of the Bankruptcy Act), the Bankruptcy Act defined "creditor" to mean "the holder of a security or securities" – a definition that contained no requirement that the issuer of the security be a debtor. Act of July 1, 1946, ch. 532, § 82, 60 Stat. 409, 410, J.A.558. And when the definition of "creditor" was amended in 1976 to mean "holder . . . of a claim against the petitioner" (and to add a definition for the term "petitioner"), *see* Act to Amend Chapter IX of the Bankruptcy Act, Pub. L. No. 94-260, § 81(3), (8), 90

Stat. 315, 315-16 (1976), J.A.579, the legislative history makes clear no substantive change was intended. *See* H.R. Rep. No. 94-686, at 16 (1975), J.A.462 (the defined term "petitioner" was added "for convenience only").

The GDB's construction of "creditor" would require the Court to conclude that these minor definitional amendments – made 30 years after enactment of the statute and adopted at the same time as Congress, after debate, re-adopted and re-affirmed Section 903(1) – fundamentally transformed Section 903(1) from a provision barring *all* state municipal composition laws into one permitting *any* state to enact such laws. This would contravene Congress' stated intent, as well as established statutory construction principles. *See Kellogg*, 135 S. Ct. at 1977 ("If Congress had meant to make such a change, we would expect it to have used language that made this important modification clear to litigants and courts."); *see also United States v. United Cont'l Tuna Corp.*, 425 U.S. 164, 168-69 (1976) ("We should . . . be as hesitant to infer that Congress intended to authorize evasion of a statute at will as we are to infer that Congress intended to narrow the scope of a statute.").[14]

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[14] The GDB attempts to bolster its construction of "creditor" with a related textual argument based on Section 903(1)'s use of the phrase "such municipality." That phrase, the GDB contends, must "refer back to the municipalities described in § 903's preamble" – and because that preamble supposedly applies only

(Continued on following page)

D. No Presumption Against Preemption Is Warranted in This Case

Petitioners rely heavily on the presumption against preemption, contending that it applies with particular force here, because preemption supposedly would (i) "oust state law from matters as peculiarly local as the fiscal management of the State's own household" and (ii) create a "no-man's land" governed by neither federal nor state law. Commonwealth Br. 28; *see also* GDB Br. 20, 25.

The brief submitted by respondent BlueMountain responds at length to these presumption issues, as well as to petitioners' reliance on the doctrine of constitutional avoidance. The Franklin Plaintiffs therefore will not burden the Court with a comprehensive discussion of these issues; instead, we limit our response to the specific points addressed below.

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in Chapter 9, the application of Section 903(1) must be similarly limited. GDB Br. 27-28.

This argument suffers from the same flaw as the "creditor" argument: It "proves too much." *See* First Cir. Op., Commonwealth-Pet. App. at 32a. If adopted, it would limit the reach of Section 903(1) to those municipalities that have actually commenced a Chapter 9 case. As a result, *all* States (not just Puerto Rico) would be free to enact their own municipal bankruptcy statutes, which municipalities could use as an alternative to Chapter 9, thereby gutting Congress' intended bar on state municipal bankruptcy statutes.

i. Municipal Bankruptcy Has Always Been the Province of Federal, Not State, Law

As discussed above, the field of municipal bankruptcy has been occupied by federal law for almost 80 years and was never the province of state law. Consequently, no presumption against preemption is warranted.

ii. Congress Has Not Relegated Puerto Rico's Government Corporations to a "No-Man's Land"

Petitioners rely on a novel presumption against creation of a so-called "no-man's land," *i.e.*, an area "immune from regulation under either federal or state law." Commonwealth Br. 28; *see also* GDB Br. 25. The Court has never articulated any such "presumption," but to the contrary has stated that Congress' "judgment must be respected whatever policy objections there may be to creation of a no-man's-land." *Guss v. Utah Labor Relations Bd.*, 353 U.S. 1, 11 (1957).

In any event, Congress has not left Puerto Rico's government corporations in a no-man's land:

1. Congress has retained jurisdiction over the restructuring of Puerto Rico and D.C. municipal debt – a sound course of action, analogous to that followed by approximately half of the states. *See* Point II.D.iii below.

2. Even if Congress ultimately chooses not to create a statutory debt restructuring regime for Puerto Rico's government corporations, this would not leave the Commonwealth without recourse. In the first place, the Commonwealth's ability to craft legislative relief of its own is not entirely foreclosed. Section 903(1) does not preempt *all* Puerto Rican laws dealing with the relationship between Puerto Rico's municipalities and their creditors; it only preempts "*composition*" laws. The Court need not decide how broad that preemption is. While other statutes may potentially survive preemption, *see Schimmel*, 751 F.3d at 430-31 (remanding case involving restructuring of retiree benefit plans under Michigan's emergency manager act for the district court to determine whether the act was a "composition" law), only the Recovery Act is before the Court, and the Recovery Act authorizes non-consensual "compositions" under any definition of that term.[15]

3. PREPA, like other Puerto Rico government corporations, could also be restructured through a receivership under both its governing trust agreement

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[15] Indeed, the Commonwealth invited preemption of the Recovery Act by deliberately crafting a composition statute explicitly modeled on Chapter 9 – though with unconstitutional powers beyond the federal statute, such as the power to seize collateral without compensation, *see* Point II.E below. While the Franklin Plaintiffs believe that a moratorium statute would not be constitutional, they note that *Ropico, Inc. v. City of New York*, 425 F. Supp. 970 (S.D.N.Y. 1976), held that such a statute was not preempted by Section 83(i), the predecessor to Section 903(1).

and applicable Puerto Rican law. *See* P.R. Laws Ann. tit. 22, § 207; Trust Agreement § 804, J.A.625. As discussed in Point III, the receivership remedy has the potential to put an end to PREPA's history of profligacy, *see* Mary Williams Walsh, *How Free Electricity Helped Dig $9 Billion Hole in Puerto Rico*, New York Times, Feb. 1, 2016, *available at* http://nyti.ms/23ExHIm, and restore PREPA to a sound fiscal and operational footing. The receiver would not be appointed or chosen by PREPA's bondholders – he or she would be appointed by a court in Puerto Rico. The fact that receivership would be initiated by creditors does not disqualify it as an available restructuring remedy; indeed, municipalities could not restructure under the 1937 federal bankruptcy law without the consent of a majority of their bondholders. *See* Act of August 16, 1937, ch. 657, § 83(a), 50 Stat. 653, 655 (1937).

4. Even if (contrary to fact) receivership was not an available remedy, the Commonwealth still would not be left in a no-man's land. Its government corporations still would have the ability to adjust their debts through negotiations with creditors. Indeed, PREPA has done precisely that: It has negotiated a consensual restructuring of its bonds through an exchange for new bonds, with reduced principal and interest, payable out of a legislatively approved electrical surcharge. Earlier this week, Puerto Rico's legislature approved, and the Governor signed into

law, legislation designed to implement the restructuring.[16]

A consensual workout of bondholder claims in the absence of statutory compulsion is not a "no-man's land." It is a land occupied by every foreign sovereign.[17] It is also occupied by every State, and by the Commonwealth itself (with respect to its *own* debts, as distinct from those of its municipalities and government corporations).[18] Indeed, the constitution of the Commonwealth, like that of some states, expressly provides that its own bonds are payable ahead of all other obligations. *See* P.R. Const. art. VI, § 8; *see also, e.g.*, N.Y. Const. art. VII, § 16.

5. Municipalities and states are not alone in having been deprived of access to federal or state

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[16] 2016 P.R. Laws Act No. 4; *see also* Mary Williams Walsh, *Puerto Rico's House of Representatives Passes Bill to Restructure $9 Billion in Debt*, New York Times, Feb. 16, 2016, *available at* http://nyti.ms/1oodG8L (stating that the enacted legislation, Act No. 4 of 2016, has been "hailed as a model for the rest of the island's debt-laden government").

[17] *See* Charles W. Mooney, Jr., *A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS (Keep it Simple, Stupid) Principle and Other Guiding Principles*, 37 Mich. J. Int'l L. (forthcoming Feb. 2016) (manuscript at 5), *available at* http://tinyurl.com/znxtkk7 ("As a general matter, during the past fifteen-plus years, voluntary, informal negotiated restructurings [of sovereign debt] have been quite successful.").

[18] Because neither a State nor the Commonwealth is a "municipality" or a "person," neither can be a "debtor." *See* 11 U.S.C. § 109(a); *see also* 11 U.S.C. § 101(41) ("person" does not include "governmental unit").

bankruptcy laws. Before 1933, interstate railroads were unable to reorganize under either federal or state law. The federal Bankruptcy Act expressly excluded interstate railroads, *see* Act to Amend the Bankruptcy Act, ch. 412, § 3, 36 Stat. 838, 839 (1910); H.R. Rep. No. 1897 at 5 (1933) (noting prior exclusion), and the interstate nature of the businesses put their restructuring beyond the competence and jurisdiction of any state's law.[19]

A railroad's inability to reorganize under either federal or state bankruptcy laws prior to 1933 did not leave financially troubled railroads with no recourse, because – like PREPA and other Puerto Rico government corporations – they had access to a receivership remedy. Railroads were able to commence court-supervised "equity receiverships" to reorganize. *See* H.R. Rep. No. 1897, at 5 (1933) (railroads "must either reorganize under some arrangement such as is provided for by this section, or be administered in

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[19] *See generally* David A. Skeel, *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 Vand. L. Rev. 1323, 1324-25, 1354-55 (1998) (railroads were unable to reorganize under federal law and, due to the interstate nature of railroads, "state legislatures proved similarly impotent"); Stephen J. Lubben, *Out of the Past: Railroads & Sovereign Debt Restructuring*, 35 Geo. J. Int'l L. 845, 845 (2004) ("[L]ike sovereign borrowers today, early American railroads faced financial distress without the benefit of an applicable bankruptcy statute."); Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 Am. Bankr. Inst. L. Rev. 5, 21-22 (1995) (discussing railroads' exclusion from federal bankruptcy law and states' inability to act).

equity receiverships"); *see generally* Warner Fuller, *The Background and Techniques of Equity and Bankruptcy Railroad Reorganizations – A Survey*, 7 Law. & Contemp. Probs. 377 (1940).[20]

iii. Congress' Retention of Jurisdiction Over the Restructuring of Puerto Rico's Municipal Debt Serves Sound Public Policies

As the First Circuit noted, "congressional retention of authority" is a sensible approach that "is not the same as a no-man's land." First Cir. Op., Commonwealth-Pet. App. at 29a-31a, n.24. As noted above, approximately half the states do not authorize their municipalities to file under Chapter 9. Just as a

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[20] Equity receiverships generally involved the recapitalization of the business through a sale to a new entity owned by creditors willing to take stock for their claims and pay cash to satisfy those not willing to accept stock. Paul D. Cravath, *The Reorganization of Corporations, in Some Legal Phases of Corporate Financing, Reorganization and Regulation* (1917) 153, 157, 178-79. It is true that PREPA's receivership statute precludes the sale of PREPA, but of course Puerto Rican law could be changed to permit the sale of PREPA. Indeed, Puerto Rican law was recently changed to authorize privatization of other government corporations, such as its major airport, through "public private partnerships." *see* Bob Sechler, *Puerto Rico Airport Is Set To Go Private*, Wall Street Journal, February 27, 2013. Puerto Rico has established a Public Private Partnership Authority to process such transactions, P.R. Laws Ann. tit. 27, § 2601 *et seq.*, and has even contemplated privatizing PREPA, Robert Slavin, *Puerto Rico Leaders Battle on Potential PREPA Privatization*, Bond Buyer, Mar. 25, 2014.

municipality in one of these states requires legislative or executive action before it can file for Chapter 9, so Puerto Rico now requires legislation from Congress before it can access Chapter 9. *See Waller v. Florida*, 397 U.S. 387, 393 (1970) ("[T]he apt analogy to the relationship between municipal and state governments is to be found between the government of a Territory and the Government of the United States.") (double jeopardy case).[21]

Moreo er, there was nothing "cavalier," Commonwealth Br. 30, about Congress' decision to withhold access to Chapter 9. To the contrary, this cautious choice reflected the commonsense concern that giving municipalities the "easy way to get out" from debt under Chapter 9 makes their "securities . . . less marketable and interest costs greater." H.R. Rep. 94-686, at 62 (1975), J.A.477 (supplemental views of Messrs. Butler, Kindness, Hutchinson, McClory, Moorehead, Hyde, and Wiggins); *see also id.* at 56, J.A.472 (separate views of Hon. Elizabeth Holtzman) (explaining that the possibility of municipal bankruptcy makes municipal bonds "a vastly more risky investment,"

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[21] For this reason, the Commonwealth's repeated mantra that debtors deprived of the "benefits of Chapter 9" cannot be subject to any "burdens of that chapter," Commonwealth Br. 2, 14, 22, 48, is misplaced. By limiting the availability of the "benefits" of Chapter 9 in Section 109(c)(2), while simultaneously limiting the availability of state law alternatives in Section 903(1), Congress plainly knew and intended that some subset of municipalities would have access to neither a state nor federal municipal bankruptcy regime.

which makes it "more difficult and costly for municipalities to borrow money in order to build schools, hospitals, and other public buildings"). This concern applies with particular force to Puerto Rico, because Congress has given special tax benefits to investments in Puerto Rico bonds. *See* 48 U.S.C. § 745 (exempting Puerto Rico bonds from federal, state and local taxes). There is nothing surprising, let alone inappropriate, about Congress' decision to retain control over whether and when Puerto Rico's municipalities may impair a nationwide class of bondholders through a bankruptcy filing.

The Commonwealth is free to return to Congress for permission to use Chapter 9 – just as Michigan law required Detroit to ask the governor for permission to file for Chapter 9, and as Chicago, for example, would have to ask Illinois for a change in law to file under Chapter 9. Indeed, Puerto Rico has done precisely that. Bills have been filed in both the House and the Senate that would amend the Bankruptcy Code to permit Puerto Rico's municipalities to file under Chapter 9, *see* Puerto Rico Chapter 9 Uniformity Act of 2015, H.R. 870, S. 1774, 114th Cong., and Speaker of the House Paul Ryan has committed to finding a solution for Puerto Rico's crisis before the end of the first quarter of 2016.[22]

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[22] *See* Jack Casey, *Committee Chair: House Can Reach March Deadline on Puerto Rico*, Bond Buyer, Feb. 1, 2016, *available at* http://tinyurl.com/hbr2w4o.

In addition, as the First Circuit noted, Congress has greater flexibility in addressing Puerto Rico's financial problems than those of the states. First Cir. Op., Commonwealth-Pet. App. at 45a ("Congress is not so constrained in addressing Puerto Rican municipal insolvency owing to Puerto Rico's different constitutional status.") (citing *Harris v. Rosario*, 446 U.S. 651, 651-52 (1980) (per curiam)). Thus, "Congress may wish to adopt other – and possibly better – options to address the insolvency of Puerto Rico municipalities that are not available to it when addressing similar problems in the states." *Id.* at 29a.

Congress may choose to enact Chapter 9 relief, alternative relief, or a combination of the two. *See* First Cir. Op., Commonwealth-Pet. App. at 29a, 45a. Or Congress may take no action. Any of these outcomes is Congress' choice to make, and none would give the Court reason to disregard the clear dictates of the statute Congress wrote. *See Guss*, 353 U.S. at 11.

E. Petitioners' Reading Would Nullify the Intended Purpose of Both Section 903(1) and Section 101(52)

As the First Circuit noted, the legislative history sheds no light on Congress' reasons for choosing to exclude Puerto Rico and the District of Columbia from Chapter 9. However, we submit that Congress could not have meant to give these two *territories* a power it had expressly denied to the *states* – namely, the power to copy Chapter 9, make it more onerous to creditors, and then enact it as their own law.

Forbidding Puerto Rico and D.C. to employ Chapter 9 but, at the same time, permitting them to enact *the same statute* as their own law would render the 1984 amendment a meaningless act. Forbidding Puerto Rico and D.C. to employ Chapter 9 but, at the same time, permitting them to enact *a more onerous statute* would undermine decades of repeated Congressional action to ensure that municipal bonds may be impaired only pursuant to a uniform federal law.

There is no question that the Recovery Act is more onerous – more destructive of the rights of creditors, particularly secured creditors – than is Chapter 9. Chapter 3 allows PREPA to discharge its bond obligations at a fraction of their amount over the objection of 100% of the PREPA Bonds. *See* Recovery Act §§ 315(d)-(e), Commonwealth-Pet. App. 238a (confirmation standards); *see also id.* § 115(c), Commonwealth-Pet. App. 188a-189a (binding effect of plan). Section 322(c) of the Recovery Act also authorizes PREPA to seize the bonds' collateral to secure a new loan without providing adequate protection to the bonds, as the Bankruptcy Code and the Fifth and Fourteenth Amendments require. *Compare* Recovery Act § 322(c), Commonwealth-Pet. App. 251a *with* 11 U.S.C. § 364(d); *see also* S. Rep. No. 95-989, at 49 (1978) (concept of adequate protection "is derived from the Fifth Amendment protection of property interests"); H.R. Rep. No. 95-595, at 338-39 (1977) (same).

The Commonwealth defends the Recovery Act as necessary to ensure an "equitable division" of assets,

Commonwealth Br. 30-13 – but as discussed at Point III below, there can be no "dash to the courthouse" that would cause an inequitable distribution of assets. It is the Recovery Act that imposes an inequitable distribution of assets, by providing for secured debt to be impaired but for multiple other categories of debt to remain "unaffected" by a Chapter 3 plan. *See* Recovery Act § 327, Commonwealth-Pet. App. 258a-260a (multiple types of trade debt, labor claims, and claims of other Commonwealth entities "shall not constitute affected debt").

The Recovery Act purports to provide "creditor protections" of several sorts, but these are largely illusory. For example, a Chapter 3 plan must promise to repay PREPA bondholders from one-half of "positive free cash flow" for up to ten years, Recovery Act § 315(k), Commonwealth-Pet. App. 239a – but this is an empty promise, since cash flow is determined by electrical rates and PREPA determines what the rates are. In addition, a Chapter 3 plan must provide bondholders with a recovery greater than they would have received by enforcing their claims on the petition date, Recovery Act § 315(d), Commonwealth-Pet. App. 238a – but this provides no real protection, since the Recovery Act separately eliminates the PREPA bondholders' rights to obtain a receiver or to compel an increase in revenues that would repay their bonds in full. *See* Recovery Act § 108(b),

Commonwealth-Pet. App. 182a (annulling right to a receiver in Section 17 of PREPA Act).[23]

III. THE RECOVERY ACT IS NOT NEEDED TO AVERT AN OPERATIONAL OR LEGAL CRISIS

Petitioners' assertions concerning the *Commonwealth's* fiscal crisis are not germane, because the Recovery Act does not apply to the Commonwealth. Petitioners' assertions that PREPA needs the Recovery Act to avert a crisis are entirely unsupported and indeed rebutted in the record below.

As respondents alleged below, in a complaint the district court sustained over a motion to dismiss, PREPA could avoid a restructuring by reducing its costs, collecting its debts and – most important – raising its rates. Dist. Ct. Op., Commonwealth-Pet.

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[23] In contrast, the "best interests" test of Chapter 9 is intended to require the debtor to do what it can to raise revenues and repay its creditors. *See* 11 U.S.C. § 943(b)(7) (court must determine that Chapter 9 plan is in the "best interests of creditors"); 124 Cong. Rec. 32,403 (1978) (remarks of Rep. Edwards) ("In making such a determination, it is expected that the court will be guided by standards set forth in *Kelley v. Everglades Drainage District*, 319 U.S. 415 (1943), and *Fano v. Newport Heights Irrigation Dist.*, 114 F.2d 563 (9th Cir. 1940)."); *Fano*, 114 F.2d at 565-66 (reversing confirmation of Chapter IX plan on ground that debtor could raise taxes to pay bondholders and refused to do so); *see also* McConnell & Picker, 60 U. Chi. L. Rev. at 465-66 (explaining "best interests of creditors" test of Chapter 9).

App. 125a-126a. None of the Recovery Act's many legislative findings say that PREPA cannot do so. To the contrary, PREPA is *required* to do so under a statute enacted one month before the Recovery Act, Act 57 of 2014, which established an energy commission to regulate PREPA's rates. Act 57 provides in relevant part:

> The Commission shall guarantee that the approved rate will be sufficient to: (i) guarantee payment of principal of and interest on bonds and other financial obligations of PREPA; and (ii) comply with the terms and provisions of the agreements entered into with or in benefit of buyers or holders of any bonds or other financial obligations of PREPA.

New § 6B(b), clause (i), to Act 83 of 1941, added on May 27, 2014 by 2014 P.R. Laws Act No. 57, § 2.8.

For the past 27 years, PREPA has not raised its "base rate," which pays for debt service and everything else other than fuel. The drop in fuel oil prices over the past year and a half has reduced PREPA's average overall rate from 26 cents per kilowatt-hour in June 2014 to less than 19 cents per kilowatt-hour in December 2015.[24] Thus PREPA could raise rates to

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[24] *Compare* P.R. Elec. Power Auth., Monthly Reports to the Governing Board June 2014, 5 (2014), *available at* http://tinyurl.com/jf7u9do, *with* P.R. Elec. Power Auth., Monthly Reports to the Governing Board December 2015, 5 (2015), *available at* http://tinyurl.com/jf7u9do.

pay its bonds today, and ratepayers would still pay much less than they did at the time this litigation was commenced.

Petitioners' allegations of power failure are wholly invented. Even apart from PREPA's ability to raise its rates, there is no danger of a cessation of "vital public services," Commonwealth Br. 32, because PREPA's trust agreement provides that revenues must be applied to operating expenses prior to any debt service payments. Trust Agreement §§ 503, 505, J.A.611-12.

Nor is there any risk of a "mad dash" to the courthouse, Commonwealth Br. 31-32, because as the First Circuit recognized, municipal property is not subject to seizure by creditors. First Cir. Op., Commonwealth-Pet. App. at 9a, n.5.[25] The Supreme Court of Puerto Rico has held that a public corporation enjoys the same immunity from asset seizure as the Commonwealth itself, at least when the attachment would "'interfere[] with the performance of its governmental functions.'" *Librotex, Inc. v. Autoridad de Acueductos y Alcantarillados de P.R.*, 138 D.P.R. 938, 941-43 (P.R. 1995) (affirming order voiding judgment

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[25] *See generally* McConnell & Picker, *supra*, at 434 ("One of the most damning criticisms of debtor-creditor law in the private sector is that individual creditors will seize property of the failing debtor without regard to the collective interest of the creditors. . . . [T]he municipal seizure rule [insulating municipal property from seizure by creditors] addresses the problem directly and largely eliminates it.").

creditor's attachment of public water authority's assets) (quoting *Arraiza v. Reyes*, 70 P.R.R. 583, 587 (1949)).

The bondholders' remedy is not seizure of assets, but rather a Puerto Rico court's appointment of a receiver – who can and will keep the lights on, and who also can and will raise rates, collect debts and cut costs. *See* P.R Laws Ann. tit. 22, § 207(b) (authorizing receiver to "exercise all the rights and powers of the Authority with respect to such undertakings as the Authority itself might do").

CONCLUSION

Petitioners argue for a topsy-turvy world, where Congress' express preemption of state municipal composition laws becomes an option for states to enact such laws, and where Congress' exclusion of Puerto Rico and the District of Columbia from Chapter 9 becomes a license for those territories to enact their own harsher versions of the same statute. Petitioners' arguments ask this Court to avoid rather than effectuate the will of Congress. Congress wanted no state-enacted (or territorially-enacted) municipal composition laws, and Congress wanted Puerto Rico and the District of Columbia to be ineligible for Chapter 9. The courts below followed Congress' mandate. We ask this Court to do the same.

The judgment of the First Circuit should be affirmed.

Dated: February 18, 2016

Respectfully submitted,

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11 U.S.C. § 903. Reservation of State power to control municipalities

This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but –

(1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and

(2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

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11 U.S.C. § 101. Definitions

* * *

(10) The term "creditor" means –

(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;

(B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i) of this title; or

(C) entity that has a community claim.

* * *

(13) The term "debtor" means person or municipality concerning which a case under this title has been commenced.

* * *

(52) The term "State" includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title.

* * *

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11 U.S.C. § 109. Who may be a debtor

* * *

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity –

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to

impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

* * *

Puerto Rico Act No. 57 of May 27, 2014

* * *

Section 2.8. – A new Section 6B is hereby added to Act No. 83 of May 2, 1941, as amended, to read as follows:

"Section 6B. – PREPA Rates.

(a) General. – The rates determined by PREPA under Section 6(l) and Section 6A of this Act shall be reviewed by the Energy Commission prior to taking effect, subject to the provisions of the Puerto Rico Energy Transformation and RELIEF Act. The rate review process shall ensure that all rates are just and reasonable.

(b) Initial Rate Review. – Rates in effect as of the effective date of the Puerto Rico Energy Transformation and RELIEF Act shall continue in effect until they are reviewed by the Energy Commission in accordance with the provisions of this Section and the Puerto Rico Energy Transformation and RELIEF Act. The first rate review process shall begin not later than one hundred eighty (180) days after the approval of the Puerto Rico Energy Transformation and RELIEF Act and shall conclude not later than six (6) months after it began. In carrying out such process, the burden of proof shall lie on PREPA which shall be required to show that such rate is just and reasonable. PREPA shall submit the information requested by the Commission, which shall include all documents pertaining to:

i. The efficiency, capacity, and suitability of the facilities and the service;

ii. Direct and indirect costs related to the generation, transmission, and distribution of energy, including stranded costs and costs attributable to the loss of energy due to theft or inefficiency;

iii. Expenditures related to PREPA's debt repayment.

iv. All charges and costs included under "Fuel Adjustment" as of the effective date of the Energy Transformation and RELIEF Act;

v. PREPA's capacity to improve the service provided and its facilities;

vi. The conservation of energy and efficient use of alternative energy resources;

vii. Data related to the effect of special laws, subsidies, and contributions; and

viii. Any other data or information that the Commission deems necessary to evaluate and approve rates.

The Commission shall guarantee that the approved rate will be sufficient to: (i) guarantee payment of principal of and interest on bonds and other financial obligations of PREPA; and (ii) comply with the terms and provisions of the agreements entered into with or in benefit of buyers or holders of any bonds or other financial obligations of PREPA. The Commission shall establish a fixed charge on the rate

that shows the amount that customers shall pay on account of PREPA's obligations to bondholders. The Commission shall review this charge in light of PREPA's financial obligations, so that it is sufficient to guarantee the annual payment of PREPA's obligations to bondholders.

The Commission shall approve under the "fuel adjustment" and "energy purchase adjustment" items only those costs directly related to the purchase of fuel and the purchase of energy, respectively. No other expense or charge may be denominated nor included as "fuel adjustment" or "energy purchase adjustment."

The Commission shall establish a mitigation plan to ensure that the costs it deems to be inconsistent with the industry practices, such as energy theft, account receivables, and losses attributed to the inefficiency of the electrical system are consistent with the industry's standards. PREPA shall comply with the mitigation plan approved by the Commission within a term that shall not exceed three (3) years.

PREPA shall bill customers the initial rate as soon as it is approved by the Commission by means of an order to that effect, with the format of the new transparent bill established in Section 6C of this Act. All rate modification requests approved by the Commission shall comply with the subsection (c) of that Section.

(c) Modification of Approved Rate. – Once the process provided in Section 6A of this Act concludes,

PREPA shall file for the Commission's approval the rate modification request. The request shall state the grounds for the change, the effect of such modification in the income and expenditures of PREPA, and any other information requested by the Commission through regulation or request. The Commission may initiate, *motu proprio*, the rate review process when in the best interest of customers. Any rate modification, whether to increase or decrease the same shall undergo a discovery and public hearing process to be held by the Commission to determine whether the proposed change is just. The review process shall not exceed one hundred eighty (180) days.

(d) Temporary Rate. – Within thirty (30) days after the filing of rate modification request, the Commission may preliminary [sic] evaluate the same to determine whether a temporary rate should be established. The Commission shall exercise its discretion in establishing the temporary rate. If the Commission establishes a temporary rate, such rate shall take effect sixty (60) days after the request was submitted. Said temporary rate shall remain in effect during the period of time needed by the Commission to evaluate the rate modification request proposed by PREPA and issue a final order therefor.

(e) Rate Modification Approval. – If after the process of public hearings, the Commission determines that the proposed rate change is just and reasonable, it shall issue an order to such purposes and notify the rate change on its website, along with the new rate itemization. The new approved rate shall

take effect sixty (60) days after the Commission issues the order. If the Commission determines that the proposed rate change is unjust or unreasonable, it shall issue an order duly grounded stating so. In such case, the rate modification subject of the request shall not proceed and the rate whose modification was sought shall continue in effect. After issuing any order after the rate review process, the Commission shall order PREPA to adjust customer's bills to refund, credit, or charge any discrepancy between the temporary rate established by the Commission and the rate change in favor of the customer or in favor of PREPA, as applicable.

(f) Inaction of the Commission. – If the Commission fails to take action with regard to a rate review request within thirty (30) days after the filing thereof, the modified rate subject of the request shall take effect immediately as a temporary rate. The Commission shall continue the review process and issue an order within the term specified in this Section. If the Commission fails to act within the term of one hundred eighty (180) days established in this Section, the modified rate shall become final and the Commission shall lose jurisdiction to review same.

(g) The Commission shall publish, on its website, the itemization of all rates or changes approved or modified.

* * *

(Official Translation)

IN THE SUPREME COURT OF PUERTO RICO

Librotex, Inc.,
and Librería y Editorial Lea, Inc.,

Plaintiffs and petitioners

v. No. CE-94-395 Certiorari

Aqueduct and Sewer Authority
of Puerto Rico *et al.*,

Defendants and respondents

JUSTICE NEGRÓN GARCÍA delivered the opinion of the Court.

San Juan, Puerto Rico, July 14, 1995.

Is it valid to attach funds from the Aqueduct and Sewer Authority to satisfy a final and unappealable judgment rendered against it? Is there an alternative remedy?

I

In 1992, the companies Librotex, Inc. (Librotex) and Librería y Editorial Lea, Inc. (Lea, Inc.) obtained judgment in the amount of $2,407,232 against the Aqueduct and Sewer Authority (Authority). Once the judgment became final and unappealable, the companies sought execution thereof by requesting the attachment "of bank accounts and/or cash or funds in the possession of third persons and/or cash located at

the offices and/or branches of the [Authority]." Appendix II, at 1. The Superior Court, San Juan Part (the Hon. Carmen Celinda Ríos, J.), issued the pertinent order, and Librotex and Lea, Inc. began to execute it by attaching $435,354.91 deposited in Citibank, N.A. The Authority filed an urgent motion in court to challenge the validity of the attachment, alleging that those funds were *public property* that belonged to a *government entity* and were vested with such great public interest that it prevented them from being attached, even in the case of an execution of judgment.

As a result, the trial court set aside the attachment order and subsequently upheld its decision on reconsideration, ruling that given the circumstances of this case, it was "inevitable to conclude that the attachment in question affect[ed] public funds destined to essential purposes." Appendix IV, at 6. In other words, it created "a no less serious consequence [by interfering] with the Authority's functions." *Id.*

Aggrieved, Librotex and Lea, Inc. have asked us to review.

II

Essentially, petitioners contend that the trial court erred in setting aside the attachment order.

Petitioners allege that when the defendant public corporation was created, the Legislature granted it fiscal and operational autonomy with respect to the

Central Government; this, consequently, gave it corporate form and sufficient powers to operate as a private business. They argue, in the *first* place, that the Puerto Rico Aqueduct and Sewer Authority Act vested the Authority with the power to sue and be sued with the clear legislative intent that it be subject to legal proceedings like any private enterprise; in *second* place, that by granting that power to said corporation, the State waived its sovereign immunity and, consequently, its protection against attachments. In support of their contention, petitioners invoke *F.H.A. v. Burr*, 309 U.S. 242 (1940); followed in *Mackey v. Lanier Collection Agency & Serv.*, 486 U.S. 825, 834 n.9 (1988), and in *Primate Protection League v. Tulane Ed. Fund*, 500 U.S. 72 (1991), and originally applied by this Court in *Arraiza v. Reyes*, 70 P.R.R. 583, 584 (1949).

On those grounds, petitioners argue that the Authority – as an autonomous corporate body whose structure is analogous to that of a private corporation – *is unconditionally subject* to attachment proceedings. We disagree.

[1] Certainly Act No. 40 of May 1, 1945, as amended, 22 L.P.R.A. § 141 *et seq.*, granted the Authority, insofar as it is pertinent here, the power "*to sue and be sued in its corporate name*, except that it may not be sued for damages arising from the real or alleged impurity, irregularity, or insufficiency of the water supplied by it and except that judicial sale of properties of the Authority shall not be permitted." 22 L.P.R.A. § 144(c). (Emphasis added.)

[2-4] However, although it is true that public corporations – such as the Authority – are autonomous in their operation, "they nonetheless retain their character as government instrumentalities created for *public utility purposes.*" *Commoloco of Caguas, Inc. v. Benítez Díaz*, 126 D.P.R. 478, 491 [26 P.R. Offic. Trans. ___, ___] (1990). (Emphasis added.) In that sense, the Puerto Rico Aqueduct and Sewer Authority Act provides: "The exercise by the Authority of the powers conferred by §§ 141-161 of this title shall be deemed and held to be an *essential government function.*" 22 L.P.R.A. § 142. (Emphasis added.) Moreover, "their operational funds are considered public funds, even if these funds do not become part of the State's budget." *Commoloco of Caguas, Inc. v. Benítez Díaz*, 126 D.P.R. at 493 [26 P.R. Offic. Trans. at ___]. *Cf. Municipio de Mayagüez v. Rivera*, 113 D.P.R. 467 [13 P.R. Offic. Trans. 597 (1982).

[5] In line with that design, we have held that the Legislature has vested the Authority with sufficient operational powers so as to consider it "as amenable to judicial process as any private enterprise would be under like circumstances, *provided there would be no interference with the performance of its governmental functions.*" *Arraiza v. Reyes*, 70 P.R.R. at 587. (Emphasis added.)

III

In this case, petitioners, as creditors of the Authority, allege that the attachment of funds up to

$2,514,650.80 *would not constitute a diversion of public funds to purposes alien to the Authority's ambit of responsibilities* because the Authority is being forced to answer for liability incurred ex delicto. We cannot endorse this approach.

[6] We take judicial notice of the serious financial crisis faced by the Authority as a result of numerous factors such as the drought that has afflicted the country almost uninterruptedly for one year. Authorizing the attachment would result in the interruption of the already affected vital service provided by said public utility to the people of Puerto Rico. The amount to be attached is considerably *high*. Although we acknowledge that petitioners are judgment creditors of the Authority, the extraordinary impact that the attachment would cause to said entity makes it necessary for us to acknowledge this protection. Consequently, the trial court did not err in setting aside the attachment order.

Now, this does not mean that petitioners are deprived of relief and will remain permanently at the mercy and exclusive will of the Authority. One thing is to order the *attachment* of the Authority's operational funds (thereby causing an immediate disruption in its operations), and another quite different thing is to grant an alternative and compatible equitable relief by simultaneously ordering the Executive Director, the Authority's Board of Directors, and any other officer to include an item in the Authority's next functional budget to satisfy the *totality* of the judgment at issue here, plus the interest accrued until the

time it is paid. We believe that this relief would do justice to petitioners while keeping the Authority free from immediate and enormous burdens that could destabilize its important public function, especially at this time, when we are facing a crisis caused by the insufficiency of our water supplies. "The contribution of the judicial task to society is best seen in times of crisis and social change when in the process of challenging the effectiveness of certain general rules, much legal creativity and rethinking is needed." Abdón Díaz Suárez, *Los jueces ante la crisis de la justicia*, 523 Rev. Gen. Der. 1669, 1673 (1988).

Judgment will be rendered accordingly.

Justice Rebollo López, with whom Justice Naveira de Rodón joined, issued an opinion concurring in the result. Justice Hernández Denton issued a concurring and dissenting opinion.

DAI/mal

(Official Translation)

IN THE SUPREME COURT OF PUERTO RICO

Librotex, Inc.,
and Librería y Editorial Lea, Inc.,

Plaintiffs and petitioners

v. No. CE-94-395 Certiorari

Aqueduct and Sewer Authority
of Puerto Rico *et al.*,

Defendants and respondents

JUSTICE REBOLLO LÓPEZ, with whom JUSTICE NAVEIRA DE RODÓN joins, concurring in the result.

San Juan, Puerto Rico, July 14, 1995

Although we *concur* in the *result* reached in the majority opinion – because of its particular and specific facts – we *cannot* endorse the *overly broad* general rule laid down by the Court today in the sense that *in no case* may a judgment creditor attach funds belonging to the Aqueduct and Sewer Authority (A.S.A.); this general rule affects and *extends* not only to *all* judgment creditors of the A.S.A., but also to *all* judgment creditors *of all the other* public corporations that operate in our country, *regardless* of the sum involved in the judgment credit.

I

We issued the pertinent writ of certiorari to review a resolution of the Superior Court of Puerto Rico, San Juan Part, that *did not* allow plaintiffs-petitioners Librotex, Inc. and Librería y Editorial Lea, Inc. to attach some A.S.A. funds deposited in Citibank, N.A., in execution of a final and unappealable judgment in the amount of $2,407,232 rendered in their favor and against the A.S.A.

In the petition for certiorari filed by plaintiffs-petitioners in this Court, they stated that the trial court had erred:

> IN DECLARING ILLEGAL THE ATTACHMENT OF FUNDS BELONGING TO THE AQUEDUCT AND SEWER AUTHORITY BASED ON THE MERE FACT THAT THESE ARE CONSIDERED PUBLIC FUNDS, IGNORING THE LEGISLATIVE INTENT BEHIND THE CREATION OF SAID AGENCY THAT IT SHALL BE SUBJECT TO JUDICIAL PROCEEDINGS JUST LIKE A PRIVATE CORPORATION, AND BY CONCLUDING THAT SAID ATTACHMENT UNDULY INTERFERED WITH THE PERFORMANCE OF THE EXECUTIVE FUNCTIONS OF SAID AGENCY.

Petition for certiorari at 7.

II

Under the "sovereign immunity doctrine," a deeply-rooted principle of Anglo-American law, the State is not liable for damage caused by its officers, agents or employees in the discharge of their functions. Ordinarily, this doctrine bars actions against the State unless it has consented to them by virtue of laws enacted to such ends.[1]

Act No. 104 of June 29, 1955, as amended, known as the Act on Claims and Suits against the Commonwealth, 32 L.P.R.A. § 3077 *et seq.*, authorized the filing of the following actions against the Commonwealth of Puerto Rico: (1) actions for damages to a person or property caused *by a culpable or negligent* act or omission of any official, agent, or employee of the Commonwealth, or of any other person acting in an official capacity within the scope of his or her duty, office, or employment; (2) actions to recover real or personal property or an interest therein, with or without compensations for damages sustained by the said property or on account of income and profits therefrom, and for the survey of rural property; and (3) civil actions in which the amount claimed does not exceed $75,000 in principal and which are based on the Constitution, or on any law of Puerto Rico, or on

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[1] Said doctrine was extended to our legal system by judicial fiat. *See Porto Rico v. Rosaly*, 227 U.S. 270 (1913). For a more detailed account of the historical background and development of this doctrine in Puerto Rico, *see Defendini Collazo et al. v. E.L.A., Cotto*, 134 D.P.R. 28 [34 P.R. Offic. Trans. ___] (1993).

any regulation of any department or division of the Commonwealth, or on any contract, express or tacit, with the Commonwealth.[2]

Regarding actions for damages to the person or property *caused by a culpable or negligent act or omission*, the Act on Claims and Suits against the Commonwealth sets *limits* on the pecuniary liability of the State. *First*, it limits to $75,000 the State's liability in cases involving a single claimant with a single cause of action; *second*, it imposes a $150,000 cap when damage is caused to more than one person or when more than one cause of action is involved. These caps were imposed after taking into account the fiscal impact of claims made against the Commonwealth. *Defendini Collazo et al. v. E.L.A., Cotto*, 134 D.P.R. 28 [34 P.R. Offic. Trans. ___] (1993). It bears noting that in *Defendini Collazo et al.* we held that insofar as the Act on Claims and Suits against the Commonwealth imposes limits on the State's economic liability, it is *not* constitutionally flawed; in other words, we upheld the constitutionality of those caps.

Under sec. 7 of the cited act, 32 L.P.R.A. § 3082, the State will promptly settle any judgment against it

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[2] By 1916, through the enactment of Act No. 76 of April 13 (32 L.P.R.A. § 3061 n.), the State had already given its consent to be sued in actions for damages based on contracts and in actions to recover real or personal property or rights on the same. *The cited Act No. 76 did not allow actions against the State for noncontractual damages.*

up to the $75,000 and $150,000 caps. If the judgment involves a money payment and it is not possible to make the payment because there are no funds for such purpose in the current budget, the corresponding appropriation of funds needed for such payment will be made in the general expense budget of the department or agency concerned for the following year.

III

Public corporations, in turn, have received a *different treatment* than that traditionally received by the different executive departments of the State *with respect to their organization and to their civil liability for damage caused by their agents, officers and other employees in the discharge of their official functions.* In that sense, sec. 4 of Act No. 104 states that its provisions will be applicable only to those independent public corporations whose power to sue and be sued is not included or established in other laws. 32 L.P.R.A. § 3079.

It is well settled that public corporations "were created to, among other things, cut costs, improve state services, and furnish the necessary infrastructure for industrial growth." *McCrillis v. Aut. Navieras de P.R.*, 123 D.P.R. 113, 127 [23 P.R. Offic. Trans. 109, 123] (1989). They arose in response to the desire to speed up and promote effectiveness in public works given the complexity of functions faced by the governments after World War I. *Commoloco of Caguas,*

Inc. v. Benítez Díaz, 126 D.P.R. 478 [26 P.R. Offic. Trans. ___] (1990); *Torres Ponce v. Jiménez*, 113 D.P.R. 58 [13 P.R. Offic. Trans. 77] (1982).

Although we recognize the existence of a wide variety of public corporations, their legal personality, as a rule, is distinct and separate from the Commonwealth, and they have been vested with faculties and powers that afford them some degree of flexibility and independence from the central government.[3] Now, we must bear in mind that public corporations *do not* lose their character as government instrumentalities created for public utility purposes, despite the autonomy and independence that characterizes them. *Commoloco of Caguas, Inc. v. Benítez Díaz.* Consequently, the operational funds of these corporate entities are considered public, despite the fact that these will not become part of the State's general budget. *Id.*

Insofar as is it pertinent here, we stated the following in *Commoloco of Caguas, Inc.*,[4] at 490-493 [26 P.R. Offic. Trans. at ___]:

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[3] As a rule, the legal personality of an executive department, unlike that of a public corporation, is not distinct and separate from the Commonwealth. *Pagán et al. v. E.L.A. et al.*, 131 D.P.R. 795 [31 P.R. Offic. Trans. ___] (1992); *Rivera Maldonado v. E.L.A.*, 119 D.P.R. 74 [19 P.R. Offic. Trans. 88] (1987).

[4] In the cited decision we extended the protection against the use of the procedural mechanism of attachment to the salaries earned by the employees of public corporations because we believed that the use of said mechanism would be highly

(Continued on following page)

In line with said functional framework, public corporations are defined as "an institution operating a service of an economic or social character, on behalf of the government, but as an independent legal entity; largely autonomous in its management, though responsible to the public, through government and parliament, and subject to some direction by the government; equipped on the other hand with independent and separate funds of its own, and the legal and commercial attributes of a commercial enterprise. These attributes would place the public corporation somewhere midway between a pure public authority and a commercial company of private law." *The Public Corporation: A Comparative Symposium* 541 (1954) (W. Friedman ed. 1954).

. . . .

Public corporations receive through their enabling statutes some degree of financial independence with regard to their operational budgets. The purpose behind this is that, in addition to any budgetary allotments they might receive from the State, these corporations strive to generate, in whole or in part, their own capital, either through the issuance of obligations, through loans, or

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detrimental and harmful to public corporations and would cause an unjustified and undue interference with the performance of the agency's functions, as well as an impermissible diversion of public funds.

through the revenues generated by the goods and services they offer. However, we must clarify that this financial autonomy will be monitored by the government to a greater or lesser degree according to the approach or public policy adopted to such ends by the country under which the public corporation operates.

Government control over public corporations in Puerto Rico is exerted through the enabling law of the public corporation concerned, as well as through any other law that directly bears upon said corporation.

. . . .

The State chooses the concept of public corporation as a tool to implement a particular public policy when it determines that the public corporation is the means through which a program may be carried out or a service offered with the highest probability of efficiency. It bears noting that a great number of these programs or services are classified as essential services. This means that although public corporations rest on a certain basis of operational autonomy, they are nonetheless vested with great government interest in that they operate according to the highest possible standards of quality and efficiency and, thus in that their operations be protected from any needless interference. [Footnotes omitted.]

Naturally, not every government agency or instrumentality is a public corporation that operates

as a private company or business. To determine what is a "state instrumentality" that functions as a private business, we have listed through caselaw a set of *factors* that must be examined, among others, when making such determination: if the employees of the agency involved are covered by the Personnel Act of the Commonwealth of Puerto Rico; if the services rendered by the agency, by their intrinsic nature, have never been rendered by a private enterprise; if the agency is capable of operating as a private enterprise or business; if the agency, in fact, operates as a private enterprise or business; the degree of fiscal autonomy enjoyed by the agency; the degree of administrative autonomy it enjoys; if prices or rates are charged for the service rendered; whether the powers and faculties conferred by the agency's organic act turn it into one essentially similar to a private enterprise; and whether the agency has the capacity to engage in the future in lucrative businesses or in activities for pecuniary profit. *See J.R.T. v. Junta de Retiro pari Maestros*, 127 D.P.R. 621 [27 P.R. Offic. Trans. ___] (1990).

Additional factors to be considered would be the very structure of the agency; its power to sue and be sued without restrictions; the power to obtain its own funds in the general stock market on the basis of its economic record and without pledging the credit of the Commonwealth; the power to acquire and administer properties without the intervention of the State; the capacity to enter into agreements or contracts; and the capacity to accept donations. *See: Pagán et al.*

v. E.L.A. et al., 131 D.P.R. 795 [31 P.R. Offic. Trans. ___] (1992); *J.R.T. v. Junta de Retiro para Maestros; Morales González v. J.R.T.*, 121 D.P.R. 249 [21 P.R. Offic. Trans. 243] (1988); A.A.A. v. *Unión Empleados A.A.A.*, 105 D.P.R. 437 [5 P.R. Offic. Trans. 602] (1976); *Canchani v. C.R.U.V.*, 105 D.P.R. 352 [5 P.R. Offic. Trans. 483] (1976).

As a general rule, and as a logical consequence of their distinct legal personality, which is separate from the State, public corporations have been vested with authority to sue and be sued in matters related to their public functions, subject to the restrictions imposed by their enabling act. *That authority ordinarily excludes them from the scope of application of Act No. 104 on claims and actions against the State.* Therefore, except as otherwise provided, *no limits are imposed on their economic liability for tortious acts committed by their officers, agents or employees in the discharge of their functions or employment.*

It is well settled that "government entities" are *exempt* from attachment proceedings, since, *as a matter of public policy,* "government activities should not be subject to the inconveniences of these proceedings which interfere with the performance of the public duties in detriment to the general welfare." *Stump Corp. v. Superior Court*, 99 P.R.R. 175, 177 (1970).

However, because of the limitations found in their respective enabling acts, public corporations, by their very nature, may be subjected to attachment

proceedings with respect to their funds and properties when the legislature has granted them sufficient operational powers so as to consider them "as amenable to judicial process as any private enterprise would be under like circumstances, provided there would be no interference with the performance of its governmental functions." *Arraiza v. Reyes*, 70 P.R.R. 583, 587 (1949).

IV

The A.S.A. was specifically created as a public corporation and autonomous government instrumentality of the Commonwealth of Puerto Rico, and the exercise of the powers vested upon it by its enabling act is deemed to be an essential government function. 22 L.P.R.A. § 142.

As we pointed out in A.A.A. v. *Unión Empleados* A.A.A., 105 D.P.R. at 456-457 [5 P.R. Offic. Trans. at 627-628]:

> The Authority is "a body corporate . . . a public corporation and autonomous governmental instrumentality of the Commonwealth of Puerto Rico . . . " 22 L.P.R.A. § 142. It has *a structure similar to that of a private corporation*, with its Governing Board and its executive personnel responsible to the Board. 22 L.P.R.A. § 143. It has perpetual existence. It may sue and be sued, although with certain restrictions, but not as broad as those protecting the State. It may contract without limitation; it may acquire and dispose of

> property; "have complete control and supervision of its properties and activities"; "borrow money and issue revenue bonds for any of its corporate purposes . . . " The bonds and other obligations issued by the Authority do not pledge the credit or taxing power of the Commonwealth of Puerto Rico. 22 L.P.R.A. § 144. The Authority charges for the services rendered and, since it deals with revenue bonds, it must collect their total value to allow, as in the case of a similar private financing, the adequate payment of the debt. 22 L.P.R.A. § 144(i) and § 152. *The Authority may unquestionably devote to activities directed to "pecuniary profit,"* within the meaning of this phrase according to our decision in *Labor Relations Board v. Junta Administrativa del Muelle Municipal y Malecón de Ponce*, 71 P.R.R. 143, 147 (1950). *The Aqueduct and Sewer Authority is unquestionably framed as a private enterprise or business and in fact operates as such.* [Emphasis added.]

It bears noting that among the faculties and powers vested in the A.S.A. are its perpetual existence as a corporation and its power to sue and be sued in its corporate name. 22 L.P.R.A. § 144(a) and 144(c). However, the Legislature limited the degree of liability of said public corporation by providing that it may not be sued for damages caused by the real or alleged impurity, irregularity or insufficiency of the water supplied by it. 22 L.P.R.A. § 144(c).

Insofar as it is pertinent here, it is *proper to emphasize* that the A.S.A.'s enabling act provided that the judicial sale of its "*properties*" would *not* be allowed. *Id.* This fact, however, does *not* mean that the A.S.A.'s *funds*, whether operational or not, are also exempted from attachment and execution of judgment proceedings. Such a conclusion would be, from our point of view, tantamount to granting the A.S.A., by judicial fiat, an immunity that the lawmaker definitely did not intend.

In sum, the A.S.A., as an autonomous public corporation whose corporate structure vests it with the powers and faculties necessary to operate as a private enterprise or business, is subject, *as a general rule*, to attachment proceedings in execution of judgment, subject to the restrictions cited above and established in its enabling act. As a matter of fact, we reached this conclusion in *Arraiza v. Reyes*, 70 P.R.R. at 587, with respect to the powers and faculties vested in the A.S.A. There, we pointed out that the Legislature clearly stated its intention that it "would be as amenable to judicial process as any private enterprise would be under like circumstances, provided there would be no interference with the performance of its governmental functions."

V

We believe that *given the specific and particular facts of the case under our consideration*, it is evident that allowing the attachment of A.S.A. funds in

execution of judgment for *such an extraordinarily high amount of money* would result precisely in an "interference with the performance of its governmental functions" that would lead, in turn, to the disastrous consequence of seriously affecting and harming the entire Puerto Rican citizenry.

However, the fact that such is the situation in the instant case must *not* lead the Court to invoke this case as grounds for establishing, just like that, an overly broad rule that all A.S.A. judgment creditors, regardless of how small their judgment credit may be, must wait for the A.S.A. "to include an item in the . . . next functional budget" to satisfy that judgment credit. This is not only unnecessary, but also totally illogical and absurd. Regardless of the fiscal crisis it faces today, the A.S.A. certainly can and must pay non-substantial sums of money to its judgment creditors.

Therefore, in situations of this type, we believe that it is absolutely logical and commonsensical that this Court should establish a rule that trial courts, when passing on a petition for attachment in execution of judgment, must determine, *on a case-by-case basis*, whether the petition unreasonably interferes with the performance of the A.S.A.'s executive functions; naturally, the grant or denial of the petition for attachment in execution of judgment will depend on

this determination.[5] This rule must *likewise* be applied in cases involving *any other* public corporation similar to the A.S.A. whose enabling act may thus allow it.

In sum, in view of the above, we believe that instead of the unnecessarily overbroad rule laid down by the majority today, it would be more logical and commonsensical to adopt the "case by case" analysis procedure as adjudicative methodology in cases of this type, which involve our country's public corporations and in which we would have to consider factors such as the amount involved, the fiscal condition of the public corporation at the time the attachment is sought, the extraordinary consequences produced by the attachment of funds, and whether the attachment unreasonably interferes with the performance of the executive operations and functions of the public corporation.

This rule, unlike the one established by the Court today, strikes a "balance of interests" between the common citizen who obtains a judgment against the A.S.A. and this public corporation – and, naturally, the citizenry in general.

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[5] If the petition for attachment in execution of judgment is denied, the trial court must order the A.S.A. to include said sum in the agency's next budget.

(Official Translation)

IN THE SUPREME COURT OF PUERTO RICO

Librotex, Inc.,
and Librería y Editorial Lea, Inc.,

Plaintiffs and petitioners

v. No. CE-94-395 Certiorari

Aqueduct and Sewer Authority
of Puerto Rico *et al.*,

Defendants and respondents

JUSTICE HERNÁNDEZ DENTON, concurring and dissenting.

San Juan, Puerto Rico, July 14, 1995.

At the request of Librotex, Inc. and Librería y Editorial Lea, Inc., we reviewed the resolution issued by the learned Superior Court, which set aside an asset attachment order issued against the Aqueduct and Sewer Authority (Authority), deeming that the attachment interfered with the functions of that public corporation.

I concur with the majority opinion, and with Justice Rebollo López's opinion concurring in the result, that the Authority is subject to attachment proceedings as long as these do not interfere with the performance of its functions. However, since I believe that no specific evidence was presented in the trial court to show that the attachment sought, or part

thereof, would interfere with the Authority's executive functions and that, therefore, the case should be remanded to the court below for it to receive and examine the evidence required to make such a determination, I dissent.

I

Civil Procedure Rule 56.1 provides: "In every action, before or after entering judgment, and on motion of claimant, the court may issue any provisional order it may deem necessary to secure satisfaction of the judgment." 32 L.P.R.A. App. III. As one of these provisional measures, this rule allows the attachment of assets and the attachment of funds in possession of a third party. The attachment order may be issued without posting *bond "[i]f a remedy is sought after judgment* is entered." Civil Procedure Rule 56.3 (32 L.P.R.A. App. III).

The amount to be attached must be limited to the sum claimed in the action or to the amount stated in the judgment. In other words, only the attachment of property of the debtor of sufficient value to cover the totality of the judgment or the total amount claimed is allowed. *Carlo v. District Court*, 58 P.R.R. 889, 894 (1941).

However, in the case of public corporations, we have held that when issuing an attachment order, trial courts are limited by the negative impact that the attachment sought could have on the capacity of the public corporation to perform its executive functions.

In that respect, in *Arraiza v. Reyes*, 70 P.R.R. 583, 587 (1949), we specifically stated that the Authority is "as amenable to judicial process as any private enterprise would be under like circumstances, provided there would be no interference with the performance of its governmental functions." This rule applies to all public corporations in our jurisdiction and must be applied taking into account the limitations imposed by the enabling act of the public corporation concerned. See, for instance, 22 L.P.R.A. § 144(c), which provides that the Authority shall not be sued for damage caused by irregularities in the water it supplies.

The cited rule is justified by the nature of public corporations and of the services they provide to the citizenry. Although public corporations are not government entities and, therefore, are not exempt from attachment proceedings – *Stump Corp. v. Superior Court*, 99 P.R.R. 175 (1970) – they serve public utility purposes, and the funds with which they operate are public funds. *Commoloco of Caguas, Inc. v. Benítez Díaz*, 126 D.P.R. 478 [26 P.R. Offic. Trans. ___] (1990). Consequently, an attachment against these corporations must not interfere with the discharge of their functions to the detriment of the citizens' welfare.

In light of said doctrine, once the creditor proceeds with the attachment, the public corporation must show, by a preponderance of evidence, that allowing the execution of the attachment sought would interfere with its capacity to perform its executive functions.

The function of the Superior Court in such a complex controversy is to determine the maximum amount that may be attached without hindering the capacity of said instrumentality to perform its governmental functions.

II

After applying the cited rules to this case, I believe that the Authority did not present evidence in the Superior Court to show that the attachment, if granted, would interfere with the Authority's capacity to perform its executive functions. The record only shows that the Authority made some allegations that if the attachment sought were granted, it would not be able to meet its payroll obligations or its previous commitments to its stockholders. In support of its allegations, the Authority invoked Governor Pedro Rosselló's Executive Order of September 13, 1993, which declared a state of emergency in the Authority and ordered its director to take whatever measures may be necessary to end said crisis.

Contrary to the pronouncements of the majority opinion, this fact does not seem evident to me. Neither do I consider sufficient evidence in that respect the fact that the Hon. Pedro Rosselló, Governor of the Commonwealth of Puerto Rico, had declared a state of emergency in the Authority through an Executive Order. The fact that an entity is facing an economic crisis does not necessarily mean that the disbursement of a specific amount of money will preclude it

from performing its executive functions. That determination depends on the assets to be attached, on the use that said public corporation gives or intends to give to those assets, and on the amount of the attachment sought.

The doctrine applicable to these cases allows the trial court to determine, after the pertinent evidence is presented, whether the attachment sought would interfere with the public corporation's capacity to carry out its executive functions. Moreover, said court has discretion to issue an attachment order for a lesser amount than the one sought if the attachment for the total amount required interferes with said entity's executive functions; the court also has discretion to make any other provision that may equitably allow the creditor to secure the remaining amount claimed or to enforce payment of the remaining judgment debt.

In the absence of evidence showing that the attachment would interfere with the Authority's executive functions, I cannot concur with the opinions issued here, which seek to protect Librotex, Inc.'s rights by forcing Authority directors to include an item in the next annual budget to satisfy the totality of the judgment rendered in this case.

The effect of said decision is that Librotex, Inc. will have to wait until the Authority's next budget is determined to collect payment of the judgment. What is more, the Authority will also be bound to pay an

additional sum of approximately $160,000 in legal interest, thus. worsening its dire economic situation.

I believe that it is important to remand the case to the learned Superior Court so that, with the benefit of the rules adopted today, it may have the opportunity to receive the pertinent evidence and determine whether the Authority is in a position to satisfy part of the judgment without hindering its capacity to perform its executive functions or whether, on the contrary, any disbursement would indeed interfere with said functions.

For the foregoing reasons, I would reverse the Superior Court's decision to set aside the attachment order issued against the Authority and would remand the case to that court for it to hold an evidentiary hearing in order to determine whether the attachment sought, or part thereof, would really interfere with the Authority's capacity to perform its executive functions.

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I CERTIFY that this is an Official Translation made by the Bureau of Translations of the Supreme Court of Puerto Rico.

In San Juan, Puerto Rico _____

By: /s/ Lcda-Sonja Isabel Ramos Zenr,
Acting Clerk

LCDA, AIDA ILEANA OQUENDO GRAULAU
Clerk of the Supreme Court